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Supreme Court, U.S.
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No. _____

In The

Supreme Court of the United States

DAVID J. FELT,

Petitioner,

v.

THE OFFICE OF THRIFT SUPERVISION,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. WHETHER A FEDERAL REGULATORY AGENCY HAS STANDING TO CONTEST THE DISCHARGEABILITY OF A DEBT WHEN IT IS NOT THE ONLY PARTY ENTITLED TO SUE UNDER THE REGULATORY ACT.

2. WHETHER A FEDERAL REGULATORY AGENCY HAS STANDING TO COLLECT A DEBT OWED TO UNRELATED THIRD PARTIES WHERE THE JUDGEMENT STATES THE REGULATORY AGENCY SHALL ASSIGN THEIR INTEREST TO THE THIRD PARTIES.

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PETITION FOR A WRIT OF CERTIORARI

Petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fifth Circuit entered in this case on June 21, 2001 affirming the district court's judgment in favor of respondent.

OPINION BELOW

The opinion of the United States Court of Appeals for the Fifth Circuit is reported at 225 F.3d 220 and reproduced at Appendix A.

STATEMENT OF JURISDICTION

The United States Court of Appeals for the Fifth Circuit rendered its opinion on June 21, 2001 affirming the judgment entered on June 29, 2000 and amended on October 25, 2000, in the United States District Court for the Southern District of Texas, Houston Division, Hon. Lee H. Rosenthal presiding.

This Court has jurisdiction pursuant to 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

The pertinent provisions of 11 U.S.C. §§ 101 and 523 are reprinted at Appendices I and J, respectively.

STATEMENT OF THE CASE[1]

In December 1983, Felt purchased all the issued and outstanding stock of Bowie County Savings & Loan Association ("Bowie"). Bowie was a state-chartered, federally insured thrift regulated by the Federal Home Loan Bank Board ("FHLBB"), the federal agency which preceded OTS as the federal thrift regulator.

Almost immediately after acquiring Bowie, Felt became the president, CEO Chairman of the Board, a director, and sole stockholder of the institution. Felt also moved the thrift's home office to Houston and changed its name to Reliance. Based upon Felt's self-dealing and harm to Reliance through the indirect sale of two loans by AGI (Felt's company), to a subsidiary of Reliance, the FHLBB's enforcement office sought Felt's consent to entry of an order removing him as a Reliance director and officer and prohibiting him from further involvement in the thrift's affairs. The FHLBB also sought a consent cease and desist order against Reliance itself based on regulatory violations. Felt consented to sell his 100% interest in Reliance, and Reliance itself consented to a cease and desist order.

Both Reliance and AGI were becoming financially distressed. Reliance's audited financial statements from 1986 showed a net worth of only $96,936, far below regulatory requirements. Similarly, AGI was insolvent by

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[1] The statement of the case is a condensed version of the factual background contained in the opinion of the Fifth Circuit Court of Appeals. That opinion is reproduced in its entirety at Appendix A. Felt vigorously disputes these "facts," but for purposes of this Petition, will not contest them.

$614,824 as of October 1986. Felt personally owed AGI over $2.1 million.

As president of AGI, Felt wrote to several hundred AGI noteholders describing AGI's financial health as poor. Without disclosing his own personal debt to AGI, the letter implied that AGI could not replay the investors' notes. But Felt offered these noteholders an opportunity to "exchange" their notes for Reliance stock.

Specifically, Felt's letter stated:

> [t]o try to solve AGI's problems by reducing its debt I will be preparing an offering circular for my stock in Reliance Savings Association for review by the Federal Home Loan Bank Board. Once the review is completed, I plan to offer you the option of exchanging your AGI note for Reliance Savings stock.

Felt included with the letter a "preliminary offering circular," which portrayed Reliance's condition as healthy. That circular relied upon Reliance's unaudited financial statements and announced that as of June 1986, Reliance's stockholder equity exceeded $1.3 million. The circular also noted that the "exchange" sale of stock would qualify for "push-down" accounting treatment, so that stockholder's equity in Reliance would rise to $4.5 million.

The circular failed to disclose the following: 1) that Reliance was subject to a cease and desist order; 2) that federal regulators were requiring Felt to dispose of all of his stock and disassociate himself from Reliance; and 3) that Specialty Finance Company, another Felt-owned entity, would finance approximately 33% of the Reliance stock purchases on favorable terms.

Felt produced a final offering circular that was never submitted to the FHLBB for approval. Felt mailed the unapproved final offering circular to potential investors. The final circular informed potential investors that Felt had now determined that the offering "is not required to be approved by the FHLBB." Felt informed the investors that audited financial reports had been prepared but were not included. Felt also stated in his circular that push-down accounting was appropriate and that Reliance would have a positive capital balance of $4.5 million after the sale.

On December 31, 1986, Felt sold all 450,000 shares of his Reliance stock at $10 per share. Approximately 150 AGI investors exchanged their notes for about 60% of the Reliance stock. A second group of five investors paid cash, and the remaining eight investors purchased roughly 33% of the remaining stock for no money down with financing from Felt's Speciality Finance Company, which held the stock as collateral for the loans.

As promised, Reliance's initial financial statements after the sale reflected a net worth of $4.5 million using push-down accounting to account for the sale of the stock. Peat Marwick later determined that push-down accounting was not appropriate in this case under generally accepted accounting principles because more than 10% of the stock was financed by Specialty Finance, the seller's entity, and thus was not at "arm's length". FHLBB analysts also concluded that the transaction was not at arm's length because (1) the noteholders already had a business relationship with Felt and it appeared they were "coerced" into swapping debt for stock, and (2) AGI was an affiliate of the seller. The FHLBB ordered Reliance to

reverse the push-down accounting entries; thus, Reliance showed a *negative* net worth of $5.6 million. Reliance was never able to recover from such a huge insolvency, and in 1988, the FHLBB placed the thrift into receivership.

The FHLBB enforcement office then commenced a rescission action against Felt, seeking an order requiring Felt to rescind the 1986 sale of Reliance stock, and alleging that Felt failed to obtain FHLBB approval of the sale and that he used an offering circular containing material misstatements and omissions. The district court found Felt liable because he failed to obtain FHLBB approval for the offering circulars as required by FHLBB regulations. After a hearing on damages, the district court ruled that when he sold the Reliance stock, Felt knew that Reliance would not be eligible to use push-down accounting and that the stock would be worthless immediately after the sale. The district court entered the Reliance Judgment awarding damages in the amount of roughly $4.2 million to OTS "in trust for individuals . . . who purchased Reliance Savings Association stock from David J. Felt during December, 1986". Felt appealed, and the Fifth Circuit summarily affirmed.

While OTS was still trying to collect on the Reliance Judgment, Felt filed for bankruptcy under Chapter 11; the case was later converted to a Chapter 7 case. OTS filed a claim against Felt's bankruptcy estate for roughly $6.4 million (the Reliance Judgment plus costs and interest). OTS then filed a complaint for determination of non-dischargeability in the bankruptcy court, thus commencing this case as an adversary proceeding under 11 U.S.C. § 523(c)(1). OTS sought a declaration that the Reliance Judgment is not dischargeable under several subsections

of 523, including (a)(4), which bars the discharge of a debt resulting from "defalcation while acting in a fiduciary capacity."

Felt appealed once again to the Fifth Circuit. Felt raised several issues including whether the OTS had standing to contest the dischargeability on behalf of the investors, particularly, where the district court order required that OTS "*shall* make a pro rata assignment *of its interest* in the judgment to all the stockholders who file a claim by September 1, 1991" (Emphasis added).[2]

In affirming the judgment, the Fifth Circuit discussed several issues raised by Felt, but failed to address the standing argument, based on the law of the case doctrine.[3]

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[2] See Final Judgment and Permanent Injunction at Appendix B.

[3] 255 F.3d at 225-26.

REASONS FOR GRANTING THE WRIT

A. THE FIFTH CIRCUIT COURT OF APPEALS DECIDED TWO IMPORTANT QUESTIONS OF FEDERAL LAW THAT HAVE NOT BEEN, BUT SHOULD BE SETTLED BY THIS COURT. SPECIFICALLY, WHETHER A FEDERAL REGULATORY AGENCY HAS STANDING TO CONTEST THE DISCHARGEABILITY OF A DEBT WHEN IT IS NOT THE ONLY PARTY ENTITLED TO SUE UNDER THE ACT; AND SECOND, WHETHER A FEDERAL REGULATORY AGENCY HAS STANDING TO COLLECT A DEBT OWED TO THIRD PARTIES WHERE THE JUDGMENT STATES THE REGULATORY AGENCY SHALL ASSIGN THEIR INTEREST TO THE THIRD PARTIES.

This case presents extremely important issues of federal law that have never been addressed by this Court, to wit: whether a federal regulatory agency has standing to contest the dischargeability of a debt when it is not the only party entitled to sue under the Act; and second whether a federal regulatory agency has standing to collect a debt owed to third parties where the judgment states the regulatory agency shall assign their interest to the third parties.

This issue is of extreme importance because it will have broad impact on virtually every federal governmental agency, including the Securities & Exchange Commission ("SEC"), the Environmental Protection Agency ("EPA"), the Secretary of Labor, the Federal Trade Commission ("FTC"), the National Labor Relations Board ("NLRB"), The Department of Energy ("DOE"), and the Office of Thrift Supervision ("OTS"), to name just a few.

This issue is also of extreme importance to all citizens who have become judgment debtors of federal regulatory agencies, based solely on their conduct with unrelated third parties.

Although this issue has been addressed by various lower courts with frequency,[4] this Court has yet to pass on this issue of great importance. This Court has addressed the issue of agency standing on only one occasion, and then, only in the broadest fashion. In *Nathanson v. National Labor Relations Board*, 344 U.S. 25 (1952), this Court was faced with the issue of whether the NLRB was a "creditor" with respect to back pay awards within the meaning of the Bankruptcy Act. This Court held, "Congress has made the Board the only party entitled to enforce the Act. A back pay order is a command to pay an amount owed the Board as agent for the injured employees. The Board is therefore a claimant in the amount of the back pay." 344 U.S. at 27.

Nathason left open two important issues that have never been addressed by this Court: (1) whether a federal regulatory agency has standing when it is not the only party entitled to enforce the Act; and (2) whether a federal regulatory agency may collect on a judgment ordered assigned to individual claimants.

This case provides the perfect vehicle for this Court to definitively decide these two important issues. Here, OTS was not the only party entitled to seek damages. In

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[4] *See, e.g., In re Egea*, 236 B.R. 734 (D. Kan. 1999); *In re Hodge*, 216 B. R. 932 (E.D. Oh. 1998); *In re Maio*, 176 B. R. 170 (S.D. In. 1994); and *In re Austin*, 138 B. R. 898 (E.D. Ill. 1992).

fact, a private investor sued in his own right and was awarded damages.[5] Moreover, the judgment explicitly stated that the Office of Thrift Supervision "*shall* make a pro rata *assignment of its interest* in the judgment to all the stockholders who file a claim by September 1, 1991." (Emphasis added.) Instead of making this assignment, the OTS proceeded in its own name to enforce the judgment.

In short, are federal regulatory agencies entitled to "super-claimant" status, whereby they may not only contest dischargeability where private parties have their own cause of action, but may also pursue collection where a judgment orders them to assign their interest.

B. A PETITION FOR CERTORARI SHOULD BE GRANTED TO RESOLVE A CONFLICT BETWEEN THE EIGHTH CIRCUIT COURT OF APPEALS AND THE FIFTH CIRCUIT COURT OF APPEALS ON THE IMPORTANT ISSUE OF WHETHER A FEDERAL REGULATORY AGENCY HAS STANDING TO CONTEST DISCHARGEABILITY WHERE THE ACT PROVIDES FOR A PRIVATE RIGHT OF ACTION TO PERSONS HARMED BY PROSCRIBED ACTS, OR WHERE THE JUDGMENT IS IN THE NAME OF OR ASSIGNED TO INDIVIDUAL CLAIMANTS.

In the landmark case of *Nathanson v. National Labor Relations Board*, 344 U.S. 25 (1952), after observing that

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[5] See Final Judgment and Permanent Injunction at Appendix B, stating in pertinent part that "Robert Udell may execute his judgment independently of the Office of Thrift Supervision."

Congress made the NLRB the only party entitled to enforce the National Labor Relations Act,[6] this Court held that "[a] back pay order is a command to pay an amount owed the Board as agent for the injured employees. The Board is therefore a claimant in the amount of the back pay." 344 U.S. at 27.

In *Cannon v. State of Missouri*, 741 F.2d 1139 (8th Cir. 1984) the Eighth Circuit Court of Appeals held that the Attorney General for the State of Missouri lacked standing under 11 U.S.C. § 523(a) to challenge the dischargeability of a debt owed to eight individuals as a result of the State's successful prosecution of the debtor under the Missouri Merchandising Practices Act. The Court distinguished *Nathason, supra*, stating: "In this case the state court specifically ordered restitution be made to the individuals. Furthermore, under the Missouri statutory scheme, the Attorney General is not the only party entitled to enforce the Act. . . . *Nathason* is therefore inapplicable." 741 F.2d at 1142.

On the other hand, the Fifth Circuit in the *Matter of Davis*, 194 F.3d 570 (5th Cir. 1999) held that the administratrix was a "creditor" with "standing" to bring a non-dischargeability complaint. Although not a federal agency case, the Fifth Circuit relied upon *Nathason v. National Labor Relations Board*, and other federal agency cases, to hold that the administratrix was a creditor with standing. 194 F.3d at 574-577. Moreover, the Fifth Circuit stated that "[t]he agencies need not be the only party entitled to enforce the Acts as their standing as creditors

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[6] 29 U.S.C. § 151 et seq.

in the nondischargeability actions obtains regardless of whether the actual beneficiaries were authorized under federal law to prosecute the action in their own right." *Id.* at 575. The Fifth Circuit added "[t]he district court's narrow interpretation of § 523(c)(1) fails to take into account the analogous jurisprudence recognizing that federal administrative agencies by virtue of their authority to enforce the administrative law are creditors in their own right with standing to object to discharge in the enforcement of federal statutory provisions, even though the agencies may not be the ultimate recipients of the debt payments." *Id.* at 575.[7]

These decisions of the Courts of Appeal are clearly in conflict with one another. This case presents an opportunity for this Court to decide this far reaching and important conflict.

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[7] Similarly the Ninth Circuit Bankruptcy Appellate Panel held that the Securities & Exchange Commission had standing to contest dischargeability even where a receiver had been appointed. "The Commission is the governmental entity that is charged with enforcing the federal security laws. The Commission's statutory power necessarily extends to the enforcement of orders, such as the disgorgement judgment. Therefore, the Commission is a judgment creditor who has a "right to payment" with standing to file a § 523(a)(2)(A) action against the Debtor." *In Re Cross*, 218 B. R. 76, 80 (BAP 9th Cir. 1998).

CONCLUSION

For the foregoing reasons, the Petition for Writ of Certorari should be granted.

Respectfully submitted,

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APPENDIX

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APPENDIX A

United States Court of Appeals,
Fifth Circuit.

255 F.3d 220

In the Matter of: David J. FELT, Debtor.
The Office of Thrift Supervision, Appellee,

v.

David J. Felt, Appellant.

No. 00-20646.

June 21, 2001.

Richard L. Rennert, Elizabeth Reitz Moore (argued), *Martin Jefferson Davis*, Office of Thrift Supervision, Washington, DC, for Appellee.

Richard B. Kuniansky (argued), Kuniansky, Karahan & Rozan, Houston, TX, for Appellant.

Appeal from the United States District Court for the Southern District of Texas.

Before *JOLLY, DeMOSS* and *STEWART*, Circuit Judges.

DeMOSS, Circuit Judge:

I.

The Office of Thrift Supervision ("OTS")[1] brought this action as an adversary proceeding in 1993 against

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[1] OTS, an office within the Department of the Treasury, is the federal agency with primary responsibility for regulating savings associations, or "thrifts."

Debtor David J. Felt ("Felt") in the Bankruptcy Court for the Southern District of Texas. OTS sought a declaration that a debt reflected in a prior district court judgment was non-dischargeable in bankruptcy as provided by 11 U.S.C. § 523.[2] In March 1997, the district court entered a final judgment declaring a portion of the debt non-dischargeable, and on appeal, a panel of this Court reversed in part and remanded. *See In re Felt*, 176 F.3d 478, No. 97-20418 (5th Cir. Mar. 1, 1999) (unpublished) (remanding to the district court for consideration of any additional evidence Felt was denied the opportunity to present when the district court granted OTS summary judgment *sua sponte* and without giving ten days notice). Following remand, the district court again entered a final judgment in favor of OTS, declaring a portion of the debt non-dischargeable. Finding no reversible error, we affirm.

II. BACKGROUND

A. The Reliance Judgment at Issue:

The following is an abbreviated summary of the facts which gave rise to the entry of the 1991 judgment, the dischargeability *vel non* of which, is the subject of this appeal.

In December 1983, Felt purchased all of the issued and outstanding stock of Bowie County Savings and Loan Association ("Bowie"), in New Boston, Texas. Bowie was a state-chartered, federally insured thrift regulated by the

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[2] The debt at issue is a final judgment ("the Reliance Judgment") for $4,271,120 plus interest and costs, entered against Felt in favor of OTS.

Federal Home Loan Bank Board ("FHLBB"), the federal agency which preceded OTS as the federal thrift regulator. Felt borrowed nearly $1.5 million for the purchase of Bowie, part from Texas Investment Bank and the remainder from American Guaranty, Inc. ("AGI"), which was Felt's wholly-owned corporation.

Almost immediately after acquiring Bowie, Felt became the president, CEO, Chairman of the Board, a director, and sole stockholder of the institution. Felt also moved the thrift's home office to Houston and changed its name to Reliance. Based upon Felt's self-dealing and harm to Reliance through the indirect sale of two loans by AGI (Felt's company), to a subsidiary of Reliance, the FHLBB's enforcement office sought Felt's consent to entry of an order removing him as a Reliance director and officer and prohibiting him from further involvement in the thrift's affairs. The FHLBB also sought a consent cease and desist order against Reliance itself based on regulatory violations.

Though Felt claims he did it just to avoid spending millions defending against the FHLBB, he consented to sell his 100% interest in Reliance, and Reliance itself consented to a cease and desist order. These agreements were memorialized in a Letter of Agreement Felt executed on August 29, 1986, and a related Memorandum of Clarification. Felt specifically agreed to either sell his Reliance stock within six months, subject to FHLBB approval of the transaction and offering materials, or to transfer his shares to a trustee. The FHLLB agreed to keep the terms of the agreement confidential, but Felt was not required to do so.

In the meantime, both Reliance and AGI were becoming financially distressed. Reliance's audited financial statements from 1986 showed a net worth of only $96,936, far below regulatory requirements. Similarly, AGI was insolvent by $614,824 as of October 1986. Felt personally owed AGI over $2.1 million.

In September 1986, as president of AGI, Felt wrote to several hundred AGI noteholders describing AGI's financial health as poor. Without disclosing his own personal debt to AGI, the letter implied that AGI could not repay the investors' notes. But Felt offered these noteholders an opportunity to "exchange" their notes for Reliance stock. Specifically, Felt's letter stated:

> [t]o try to solve AGI's problems by reducing its debt I will be preparing an offering circular for my stock in Reliance Savings Association for review by the Federal Home Loan Bank Board. Once the review is completed, I plan to offer you the option of exchanging your AGI note for Reliance Savings stock.

Felt included with the letter a 72-page "preliminary offering circular," which portrayed Reliance's condition as healthy. That circular relied upon Reliance's unaudited financial statements and announced that as of June 1986, Reliance stakeholder equity exceeded $1.3 million. The circular also noted that the "exchange" sale of stock would qualify for "push-down" accounting treatment, so that stockholder's equity in Reliance would rise to $4.5 million.[3]

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[3] Push-down accounting permits an acquired thrift to push down the value that is paid for the stock to the balance sheet, to

Felt admitted that he acted as the coordinator for the offering circular and that he reviewed the preliminary circular before causing it to be sent out. However, that circular failed to disclose the following: 1) that Reliance was subject to a cease and desist order; 2) that federal regulators were requiring Felt to dispose of all of his stock and disassociate himself from Reliance; and 3) that Specialty Finance Company, another Felt-owned entity, would finance approximately 33% of the Reliance stock purchases on favorable terms. Felt's attorney advised him to make the fullest disclosure possible in the circular and to obtain FHLBB approval of the offering circular "as a hedge against claims of failure to disclose material information or the making of misleading statements," but his lawyer never knew about the Letter of Agreement and Memorandum of Clarification requiring Felt to sell and disassociate from Reliance. Felt claims that he didn't disclose these matters because of the confidentiality clause.

On September 23, 1986, Felt's attorney sent a Form OC (Offering Circular) for the sale of Reliance stock to the FHLLB for its review and approval. FHLLB's legal staff responded to Felt's attorney that the circular was materially deficient and that it could not even be reviewed without audited 1986 financial statements with the auditors' opinions. Felt's lawyer informed Felt of the

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the net worthsection. Even though the thrift itself does not receive the money, the value the new owners pay for the stock establishes a new basis for the thrift's assets, liabilities, and equity. The books show the excess of the purchase price over fair market value as the intangible asset "goodwill."

FHLBB's response. Felt contacted Reliance's outside auditors (the firm of Peat, Marwick et al.) and requested an opinion for the offering documents. The auditors, however, refused "to be associated with the circular at all." Peat Marwick had been auditing Reliance's June 1986 consolidated financial statements and issued a report explaining that it could not opine that the statements were in accord with generally accepted accounting principles because it had not been provided adequate information from Reliance.

Felt continued with efforts to and did produce a final offering circular, and that circular was never submitted to the FHLBB for approval. On December 22, 1986, Felt mailed the unapproved final offering circular to potential investors. The final circular contained a disclosure statement to highlight changes from the preliminary circular, and it informed potential investors that Felt had now determined that the offering "is not required to be approved by the FHLBB." Felt informed the investors that audited financial reports had been prepared but were not included. Felt also stated in his circular that push-down accounting was appropriate and that Reliance would have a positive capital balance of $4.5 million after the sale.

On December 31, 1986, Felt sold all 450,000 shares of his Reliance stock at $10 per share. Approximately 150 AGI investors exchanged their notes for about 60% of the Reliance stock. A second group of five investors paid cash, and the remaining eight investors purchased roughly 33% of the remaining stock for no money down with financing from Felt's Specialty Finance Company, which held the stock as collateral for the loans.

As promised, Reliance's initial financial statements after the sale reflected a net worth of $4.5 million using push-down accounting to account for the sale of the stock. Peat Marwick later determined that push-down accounting was not appropriate in this case under generally accepted accounting principles because more than 10% of the stock was financed by Specialty Finance, the seller's entity, and thus was not at "arm's length". FHLBB analysts also concluded that the transaction was not at arm's length because (1) the noteholders already had a businessrelationship with Felt and it appeared they were "coerced" into swapping debt for stock, and (2) AGI was an affiliate of the seller. Felt conceded in his deposition that he "probably" knew that 90% and that he "definitely" knew that a high percentage of his Reliance stock had to be sold at arm's length to qualify for push-down accounting. The FHLBB ordered Reliance to reverse the push-down accounting entries; thus, Reliance showed a *negative* net worth of $5.6 million. Suffice it to say, Reliance was never able to recover from such a huge insolvency, and in 1988, the FHLBB placed the thrift into receivership.

In April 1988, the FHLBB enforcement office commenced a rescission action against Felt, seeking an injunction and an order requiring Felt to rescind the 1986 sale of Reliance stock, and alleging that Felt failed to obtain FHLBB approval of the sale in violation of 12 C.F.R. § 563g.2 and that he used an offering circular containing material misstatements and omissions in violation of 12 C.F.R. § 563g.10. On July 24, 1989, the district court, Judge Lynn Hughes presiding, found Felt liable because he failed to obtain FHLBB approval for the offering circulars

as required by FHLBB regulations. After a hearing on damages, the district court ruled that when he sold the Reliance stock, Felt knew that Reliance would not be eligible to use push-down accounting and that the stock would be worthless immediately after the sale. On January 9, 1991, the district court entered the Reliance Judgment awarding damages in the amount of roughly $4.2 million to OTS "in trust for individuals . . . who purchased reliance Savings Association stock from David J. Felt during December, 1986." Felt appealed, and a prior panel of this Court summarily affirmed.

B. Post-Reliance Judgment Facts:

On September 1, 1992, while OTS was still trying to collect on the Reliance Judgment, Felt filed for bankruptcy under Chapter 11; the case was later converted to a Chapter 7 case. On June 25, 1993, OTS filed a claim against Felt's bankruptcy estate for roughly $6.4 million (the Reliance Judgment plus costs and interest). In July, OTS filed a complaint for determination of non-dischargeability in the bankruptcy court, thus commencing this case as an adversary proceeding under 11 U.S.C. § 523(c)(1). OTS sought a declaration that the Reliance judgment is not dischargeable under several subsections of 523, including (a)(4), which bars the discharge of a debt resulting from "defalcation while acting in a fiduciary capacity." The parties filed dispositive cross motions on the discharge issue. In November 1994, the district court withdrew the reference from the bankruptcy court and assigned the case to Judge Lee Rosenthal, who on September 25, 1995, issued an order disposing of various

motions including a motion brought by Felt for a determination that he was not a fiduciary under §§ 523(a)(4) and (e), or the common law. The district court ruled that Felt was a fiduciary under § 523(a)(4), the plain language of § 523(e),[4] and the common law, and asked that OTS submit a proposed final judgment or identify unresolved issues.

OTS submitted the following unresolved issues: (1) whether OTS had standing to pursue the non-dischargeability action; and (2) whether Felt's breaches of fiduciary duty reflected a "willful" neglect of duty as would be required for a finding of defalcation under § 523(a)(4).

The district court, without further briefing, granted OTS's cross-motion for partial summary judgment, dismissing Felt's affirmative defense that OTS lacked standing. The court ruled *sua sponte* that Felt's acts were "willful" as a matter of law, and the district court entered a final judgment on March 31, 1997. Felt appealed, and a prior panel of this Court "reversed in part, vacated in part, and remanded in part" as to the district court's *sua sponte* grant of summary judgment on the question of willfulness. *See In re Felt*, 176 F.3d 478, No. 97-20418 (5th Cir. Mar. 1, 1999) (unpublished). On remand, OTS moved for summary judgment on the issue of willfulness, and after full briefing, the district court granted OTS's motion

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[4] According to § 523(e), "[a]ny institution-affiliated party of a depository institution or insured credit union shall be considered to be acting in a fiduciary capacity with respect to the purposes of subsection (a)(4) or (11)."

on June 29, 2000. From the final judgment entered thereupon, Felt timely appeals.

III. DISCUSSION

A. *Whether Felt can relitigate whether he was a fiduciary, whether he breached his fiduciary duties, and whether OTS has standing to contest the dischargeability of a debt on behalf of investors?*

As a preliminary matter, OTS argues that certain issues in this case have been resolved by the prior panel, and that disposition is the law of the case. Specifically, OTS argues that our prior panel necessarily had to have decided that Felt had a fiduciary duty and breached the same to make relevant the determination of willfulness. Had no such finding been implicitly made by the prior panel, argues OTS, the issue of willfulness would have been irrelevant and there would have been no reason to remand. As OTS argues, the prior panel first accepted and affirmed, albeit implicitly, the district court's rulings that Felt was a fiduciary and that he breached his fiduciary duties.

It is clear from a reading of the prior panel's opinion that the only issue explicitly addressed was the district court's *sua sponte* grant of summary judgment on the issue of Felt's willfulness. The partial remand by the prior panel also was explicitly linked to consideration of any additional evidence that Felt produced "on the issue of willfulness." Implicit in the prior panel's consideration on the issue of willfulness are the prerequisite findings that Felt had and breached a fiduciary duty to Reliance and the AGI investors. However, Felt argues that the only

"holding" of the prior panel is with respect to the procedural defect in the district court's grant of summary judgment *sua sponte* on the issue of willfulness.

We find adequate support for OTS's argument in our own precedent. The law of the case doctrine applies not only to issues decided explicitly, but also to everything decided "by necessary implication." *See Browning v. Navarro*, 887 F.2d 553, 556 (5th Cir.1989). And, though not expressly addressed in an initial appeal, those matters that were fully briefed to the appellate court and were necessary predicates to the ability to address the issue or issues specifically discussed are deemed to have been decided tacitly or implicitly, and their disposition is law of the case. In *Knotts v. United States*, 893 F.2d 758 (5th Cir.1990), a personal injury claim under the Federal Tort Claims Act, the government asserted immunity as a defense. The district court rejected immunity, found both the government and the plaintiff to be negligent, and apportioned 100% of the fault to the victim. On appeal, the government argued the district court's error in rejecting immunity. On appeal, this Court did not expressly address the immunity argument, but went on to vacate the judgment on other grounds, and it ordered reapportionment of fault. In a second appeal, the government tried again to raise its immunity defense, but we held that the immunity defense was foreclosed by our decision in the prior appeal. *See id.* at 761. In so doing, we stated that although not expressly addressed in the prior opinion, the immunity defense was briefed and considered. *Id.* Specifically, we stated "by remanding the case with instructions that the district court apportion fault . . . we

indicated, albeit tacitly, our rejection of the United States' claim of immunity." *Id.*

Here, the issues of whether Felt was a fiduciary, whether Felt breached his fiduciary duty, and whether OTS had standing to bring the non-dischargeability action, were briefed, and are necessary prerequisites to the relevance of considering the issue of willfulness. Consequently, we find persuasive the argument that the district court's findings on those issues were implicitly affirmed by the prior panel and are the law of the case. Our review of Felt's brief to our prior panel convinces us that those issues were fully briefed to the prior panel and were, therefore, implicitly affirmed. Consequently, we conclude that the law of the case doctrine precludes reconsideration of the issues of Felt's fiduciary status, his breach of his fiduciary duties, or OTS's standing to pursue this action.

B. Whether the summary judgment evidence established as a matter of law that Felt willfully engaged in defalcation in breach of his fiduciary duties?

Here, Felt challenges the merits of the district court's conclusion that, based upon the undisputed summary judgment evidence, Felt's breaches of his fiduciary duties were willful and, thus, constituted defalcation under § 523(a)(4). We review a district court's award of summary judgment *de novo*, applying the same standards applicable in the district court. *See Sherrod v. American Airlines, Inc.*, 132 F.3d 1112, 1119 (5th Cir.1998). And we review the summary judgment evidence in the light most favorable to the non-moving party, in this case Felt. *See*

Melton v. Teachers Ins. & Annuity Ass'n, 114 F.3d 557, 559 (5th Cir.1997). Summary judgment under Rule 56 of the Federal Rules of Civil Procedure is thus appropriate only if

> . . . the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law.

Fed.R.Civ.P. 56(c).

The central issue in this case boils down to whether Felt's breaches constitute defalcation for purposes of § 523(a)(4), in which case, the debt at issue would be nondischargeable in bankruptcy. The defalcation determination turns on the issue of whether Felt's breaches were "willful." *See Moreno v. Ashworth*, 892 F.2d 417, 421 (5th Cir.1990) (stating that "defalcation is a willful neglect of duty, even if not accompanied by fraud or embezzlement"); *see also Schwager v. Fallas*, 121 F.3d 177, 184, 185 (5th Cir.1997). This Court has described the "willful neglect" of fiduciary duty as "essentially a recklessness standard." *Schwager*, 121 F.3d at 185. Thus, willfulness is measured objectively by reference to what a reasonable person in the debtor's position knew or reasonably should have known. *See Roy v. Gravel*, 143 B.R. 825, 828 (W.D.La.1992), *aff'd*, 983 F.2d 1062 (5th Cir.1993). The objective standard charges the debtor with knowledge of the law without regard to an analysis of his actual intent or motive. *Id.* at 828.

i. Duty to Reliance

First, with respect to Felt's fiduciary duty to Reliance, the district court concluded that Felt breached his duties to Reliance, not just in one, but in three ways, each of which independently supports a finding of defalcation: (1) he willfully failed to obtain FHLBB approval of his final offering circulars; (2) he willfully drafted and used circulars that contained material omissions; and (3) he willfully misrepresented that Reliance would be able to use push-down accounting to create a positive net worth after completion of the stock sale. For the reasons noted below and for substantially the same reasons stated by the district court, we find that there is no genuine dispute that the evidence establishes Felt's "willful" breach of the duty to Reliance.

FHLBB regulations explicitly require that offering circulars be approved by the FHLBB. *See* 12 C.F.R. § 563g.2. As noted above, as a fiduciary, Felt is *presumed* to know his legal obligations, but beyond this fact, here, Felt had *actual knowledge* of the approval requirement. The Letter of Agreement explicitly put Felt on notice that in addition to requiring that he divest his interest in the Reliance stock, he was to obtain approval of any offering circular or supporting materials. His understanding of this fact is also evidenced by the undisputed fact that he submitted his preliminary circular to the FHLBB for approval. Despite his knowledge that he needed approval, Felt nonetheless caused the final offering circular to be mailed to potential investors without FHLBB approval.

FHLBB regulations also contain an explicit requirement that the offeror must make full and truthful disclosures in offering materials. *See* 12 C.F.R. § 563g.10. Felt's attorney testified that he expressly informed Felt of this duty, and Felt admitted as much when he stated that he reviewed the offering materials for "accuracy." Notwithstanding his understanding of this duty, Felt falsely wrote that the final offering *did not* require FHLBB approval. Additionally, the offering circulars failed to disclose that Felt was required by the Letter of Agreement to dispose of all of his Reliance stock, or that Reliance was subject to a cease and desist order.

Concomitant with the duty not to make material omissions is the duty not to make material misrepresentations in offering materials. *See* 12 C.F.R. § 563g.10. The evidence here reveals, through his own testimony, that Felt was aware that in order to qualify for push-down accounting, thus increasing Reliance's paper worth, more than 90% of the transactions would have to be "at arm's length." In this case, a substantial majority of the stock sale was not at arm's length by virtue of the fact that more than 30% of the stock was financed by Specialty Finance and that Felt acted as the coordinator for the sales transaction while simultaneously controlling Reliance, AGI, and Specialty Finance. The record unambiguously establishes that, at the time he prepared and distributed the final offering materials, Felt objectively knew or should have known that the stock sale would not qualify for push-down accounting and, thus, the stock would instantly be worthless upon sale. This is probably the most egregious example of Felt's willful behavior

which qualifies as defalcation within the meaning of § 523(a)(4).

ii. Duty to AGI Investors

Finally and simply put, with respect to Felt's duty to the AGI investors, the record establishes that in addition to the material misstatements and omissions made to the AGI noteholders (potential investors), Felt utterly failed to disclose the personal benefits he would obtain from the transaction. He also failed to disclose to the potential investors that he personally owed AGI $2.1 million ($1.9 million of which was due the day after the stock sale), which if paid off would have increased the solvency of AGI. Given the aforementioned actual and imputed knowledge of his duty to make full and truthful disclosures in his offering materials, these misstatements and omissions demonstrate at a very minimum the recklessness required for a finding of defalcation under § 523(a)(4).

IV. CONCLUSION

Having conducted a de novo review of this case and having considered the parties' respective briefing with the benefit of oral argument, we find no reversible error. Accordingly, the judgment of the district court is affirmed for the reasons stated in the district court's memorandum and order.

AFFIRMED.

APPENDIX B

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS

FEDERAL HOME LOAN BANK BOARD, Plaintiff, *versus* DAVID J. FELT, Defendant.	§	CIVIL ACTION No. H-88-1204

FINAL JUDGMENT AND PERMANENT INJUNCTION

(Filed Jan. 9, 1991)

1. *Permanent Injunction.*

   a. By June 30, 1991, David J. Felt shall divest himself of all securities of federally-insured depository institutions and of their holding companies. In doing so, Felt shall comply with the regulations of the Office of Thrift Supervision. 12 C.F.R. § 563g.2.

   b. After June 30, 1991, David J. Felt is permanently enjoined from purchasing, selling, promoting, underwriting, or otherwise participating in the issuance, purchase, or sale of stock in federally-insured depository institutions.

   c. David J. Felt is permanently enjoined from participating in any manner in the affairs of a federally-insured depository institution, unless he receives prior written approval of the Office of Thrift

Supervision and the agency responsible for the regulation of the depository institution.

2. *Robert Udell.* Robert Udell shall recover from David J. Felt:

   a. Principal: $228,000;

   b. Prejudgment interest: $82,396.80;

   c. Costs of court; and

   d. Post judgment interest at 7.02% per annum.

3. *Office of Thrift Supervision.* The Office of Thrift Supervision, in trust for individuals other than Robert Udell who purchased Reliance Savings Association stock from David J. Felt during December, 1986, shall recover from David J. Felt:

   a. Principal: $4,271,120;

   b. Prejudgment interest: $1,537,603.20;

   c. Costs of court; and

   d. Post judgment interest at 7.02% per annum.

4. *Reliance Savings Association Stockholders.*

   a. By February 28, 1991, the Office of Thrift Supervision shall send a copy of this judgment, by first class mail, to each person who purchased Reliance Savings Association stock from David J. Felt in December, 1986, and whose purchase is reflected in the stockholder list (filed in this action).

   b. Each stockholder has until September 1, 1991, to file a claim with the Office of Thrift Supervision

for rescissional damages of $10.00 per share of Reliance stock purchased by the stockholder in December, 1986. A stockholder who does not respond by September 1, 1991, loses further opportunity to participate in a judgment against Felt.

c. The Office of Thrift Supervision shall make a pro rata assignment of its interest in the judgment to all the stockholders who file a claim by September 1, 1991. Robert Udell may execute his judgment independently of the Office of Thrift Supervision.

Signed on December 31, 1990, at Houston, Texas.

/s/ Lynn N. Hughes
Lynn N. Hughes
United States
District Judge

APPENDIX C

IN THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF TEXAS HOUSTON DIVISION

OFFICE OF THRIFT SUPERVISION,	§	
Plaintiff,	§	CIVIL ACTION NO.
VS.	§	H-94-3979
DAVID J. FELT,	§	
Defendant.	§	

MEMORANDUM AND ORDER

(Filed Sep. 25, 1995)

Pending before this court are the second and third motions for partial summary judgment filed by defendant David J. Felt ("Felt") (Docket Entry No. 2 and 12). Based on a careful review of the pleadings, submissions, and applicable authorities, and for the reasons stated below, this court GRANTS the second motion and DENIES the third motion. The remaining related motions (Docket Entry Nos. 6 and 7) are MOOT.

I. Background

In 1985, Felt purchased all the issued and outstanding stock of Bowie County Savings and Loan Association ("Bowie County Savings and Loan") and became its president, chairman of the board, director, and chief executive officer. Felt moved Bowie County Savings and Loan to Houston and changed its name to Reliance Savings Association ("Reliance"). In April 1986, the Federal Home

Loan and Bank Board ("FHLBB") sought Felt's removal as Reliance's president and chairman. The removal was based on a transaction in which a wholly owned subsidiary of Reliance purchased two loans sold by American Guaranty, Inc. ("AGI"), a company owned by Felt.

In June 1986, Felt agreed to sell his Reliance stock and consented to a proposed cease and desist order. The FHLBB Office of Enforcement agreed to accept the stock sale in lieu of a removal and prohibition order. This agreement was embodied in an August 29, 1986 Letter Agreement signed by Felt. The Letter Agreement provided that "[u]pon FHLBB approval of the purchasers' application . . . or transfer of . . . shares to a trustee, . . . [Felt] shall not thereafter serve as a director, officer, agent or employee of Reliance. . . . " (Docket Entry No. 5, Tab 4).

As president of AGI, Felt sent AGI investors a letter describing AGI's difficulties and offering the investors Felt's Reliance stock in exchange for their AGI stock. Felt's offer was made through a Preliminary Offering circular consisting of 72 pages that painted a bright picture of Reliance. (*Id.*, Tab 2, p. 9). The Circular did not disclose that federal regulators had obligated Felt to sell all his Reliance stock within six months of August 29, 1986. The Circular also did not disclose that Specialty Finance Co., a Felt-owned company, would finance purchases of approximately 33 percent of Reliance stock on a non-recourse basis with no money down. (*Id.*, Tabs 2, 8, 10, 11).

On December 31, 1986, Felt sold and transferred all 450,000 shares of his Reliance stock. (*Id.*, Tab 12, ¶ 3).

Reliance's initial unaudited financial statements as of December 31, 1986 used "pushdown" accounting to account for Felt's sale of his stock. However, the FHLBB and Peat, Marwick, Main & Co., Reliance's outside auditors, ultimately determined that the stock sales did not quality for "pushdown" accounting treatment. (*Id.*, Tab 6, ¶ 2). When Reliance restated its unaudited financial statements on a historical cost basis, Reliance was insolvent as of December 31, 1986 by $5,681,971. (*Id.*, Tab 16).

In April 1988, the FHLBB brought suit in federal district court to rescind Felt's sale of his Reliance stock. [*Federal Home Loan Bank Board v. David J. Felt*, Civil Action No. H-88-1204]. After a trial, the court found that Felt had violated the applicable securities laws by failing to secure the FHLBB's approval of the Offering Circular Felt used to sell his Reliance stock. The court found that Felt had obtained $4.5 million from approximately 170 individuals by the sale of Felt's "worthless" Reliance stock. The court found that when Felt sold his stock, he knew or reasonably should have known the circumstances that led the FHLBB to require Reliance to reverse its "pushdown" accounting entries. (Docket Entry No. 5, Tab 15, p. 97)

On December 30, 1990, the district court entered final judgment against Felt and in favor of the Office of Thrift Supervision ("OTS"), as trustee for the stock purchasers, in the principal amount of $4,271,120, plus prejudgment interest of $1,537,603.20, costs of suit, and post-judgment interest at the rate of 7.02 percent per annum. (Docket Entry No. 2, Ex. A). The Fifth Circuit affirmed, and the judgment in that case is not final.

On September 1, 1992, Felt filed a petition in the United States Bankruptcy Court for the Southern District of Texas to reorganize under Chapter 11. That action was subsequently converted to a Chapter 7 case. On July 8, 1993, the OTS began an adversary proceeding, seeking a declaratory judgment that Felt's judgment debt from the district court litigation was nondischargeable. In Felt's third motion for partial summary judgment, Felt contends that he was not a fiduciary with respect to the shareholders he is alleged to have injured. Felt asserts that his indebtedness is dischargeable despite 11 U.S.C. § 523(a)(4). In Felt's second motion, he challenges the amount of indebtedness subject to discharge.

II. The Standard for Summary Judgment

Summary judgment is appropriate if no genuine issue of material fact exists and the moving party is entitled to judgment as a matter of law. Fed. R. Civ. P. 56. Under Fed. R. Civ. P. 56(c), the moving party bears the initial burden of "informing the district court of the basis for its motion, and identifying those portions of [the record] which it believes demonstrate the absence of a genuine issue for trial." *Matsushita Elec. Ind. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 586-87, 106 S. Ct. 1348, 1355-56 (1986); *Leonard v. Dixie Well Serv. & Supply, Inc.*, 828 F.2d 291, 294 (5th Cir. 1987). An issue is "genuine" if the evidence is sufficient for a reasonable jury to return a verdict for the nonmoving party. *Anderson*, 477 U.S. at 248, 106 S. Ct. at 2510. A fact is "material" if its resolution in favor of one party might affect the outcome of the suit under governing law. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248, 106 S. Ct. 2505, 2510 (1986). The party

moving for summary judgment must demonstrate the absence of a genuine issue of material fact, but need not negate the elements of the nonmovant's case. *Little v. Liquid Air Corp.*, 37 F.3d 1069, 1075 (5th Cir. 1994) *en banc*. If the moving party fails to meet its initial burden, the motion for summary judgment must be denied, regardless of the nonmovant's response. *Little*, 37 F.3d at 1075.

Where the moving party has met its Rule 56(c) burden, the nonmovant cannot survive a motion for summary judgment by resting on the mere allegations of its pleadings. *Isquith v. Middle South Utilities, Inc.*, 847 F.2d 186, 199 (5th Cir. 1988). The nonmovant must go beyond the pleadings and designate specific facts showing that there is a genuine issue for trial. *Little*, 37 F.3d at 1075, (citing *Celotex*, 106 S. Ct. at 2553-54). The nonmovant's burden is not satisfied with "some metaphysical doubt as to the material facts." *Little*, 37 F.3d at 1075 (citing *Matsushita*, 106 S. Ct. at 1356), or by "unsubstantiated assertions," "conclusory allegations," or a mere "scintilla" of evidence. *Little*, 37 F.3d at 1075 (citations omitted). The nonmoving party must come forward with "specific facts showing that there is a *genuine issue for trial.*" *Matsushita*, 475 U.S. at 586-87, 106 S. Ct. at 1356 (quoting Fed. R. Civ. P. 56(e)) (emphasis in original); *Celotex Corp. v. Catrett*, 477 U.S. 317, 322-23, 106 S. Ct. 2548, 2552 (1986); *Leonard*, 828 F.2d at 294.

In deciding a summary judgment motion, "[t]he evidence of the nonmovant is to be believed, and all justifiable inferences are to be drawn in his favor." *Anderson*, 477 U.S. at 255, 106 S. Ct. at 2513. This court must resolve factual controversies in favor of the nonmoving party, but only when there is an actual controversy, that is, when

both parties have submitted evidence of contradictory facts. *Little*, 37 F.3d at 1075. The court does not, however, "*in the absence of any proof, assume that the nonmoving party could or would prove the necessary facts.*" *Id.* (emphasis in original). Resolving actual disputes of material facts in favor of the nonmoving party "is a world apart from assuming that general averments embrace the specific facts needed to sustain the complaint. It will not do to presume the missing facts because without them the affidavits would not establish the injury that they generally allege." *Little*, 37 F.3d at 1075.

The nonmoving party's burden is not affected by the type of case; summary judgment is appropriate in *any* case where critical evidence is so weak or tenuous on an essential fact that it could not support a judgment in favor of the nonmovant. *Little*, 37 F.3d at 1069 (citing *Armstrong v. City of Dallas*, 997 F.2d 62 (5th Cir. 1993). "Rule 56 *mandates* the entry of summary judgment, after adequate time for discovery, and upon motion, against a party who fails to make a showing sufficient to establish the existence of an element essential to that party's case, and on which that party will bear the burden of proof at trial." *Little*, 37 F.3d at 1075 (citing *Celotex*, 106 S. Ct. at 2552).

III. The Exceptions to Discharge Under Bankruptcy Code Section 523: Felt's Third Motion for Summary Judgment

Section 523(a)(4) provides that "a discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt

. . . for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny. . . . " 11 U.S.C. § 523(A)(4). Section 523(e) provides that "[a]ny institution-affiliated party of a insured depository institution shall be considered to be acting in a fiduciary capacity with respect to the purposes of subsection (a)(4) or (11)." The issue raised by Felt's third motion for summary judgment is whether he was "acting in a fiduciary capacity" under either subsection (a)(4) or subsection (e). Felt's debt is dischargeable if no genuine issue of material fact exists as to the applicability of these subsections.

A. The Applicability of Section 523(e)

On November 29, 1990, almost two years before Felt filed his bankruptcy petition, Congress enacted the Crime Control Act of 1990, Pub. L. No. 101-647, 104 Stat. 4789. This act added subsection (e) to section 523 of the Bankruptcy Code. Section 101(33) of the Bankruptcy Code provides that with respect to an insured depository institution, the term "institution-affiliated party," used in section 523(e), shall have the meaning given in section 3(u) of the Federal Deposit Insurance Act ("FDIC"), 12 U.S.C. § 1813(u). Section 1813(u) defines "institution-affiliated party" to include:

> (1) Any director, officer, employee, or controlling shareholder (other than a bank holding company) of, or agent for, an insured depository institution . . .
>
> (3) Any shareholder (other than a bank holding company), consultant, joint venture partner, and any other person as determined by the

> appropriate Federal banking agency (by regulation or case-by-case) who participates in the conduct of the affairs of an insured depository institution;. . . .

Felt contends that section 523(e) applies only to a debtor who acted on behalf of an insured depository institution, not to a third-party with whom the debtor has dealt in an "arms-length transaction." Felt argues that the legislative history of section 523(e) shows that this section, part of the Crime Control Act of 1990, was added to the Bankruptcy Code to punish insiders whose acts injured depository institution. Section 523(e) was added to the Bankruptcy Code so that "the officers and directors who were most responsible for the collapse of the savings and loan industry would not be allowed to discharge the debts which accrued due to their improprieties." *In re Gambert*, 149 B.R. 819, 825 (E.D. Tex. 1992), *citing In re Chavez*, 140 B.R. 413, 420 (Bankr. W.D. Tex. 1992) (*citing* H.R. Rep. No. 101-681(I), 101st Cong., 2d Sess. 180-81 (1990). "[T]hese are changes to the Bankruptcy Code which close off the Bankruptcy escape hatch for bank and thrift insiders whose acts of financial fraud and malice will end up adding perhaps half a trillion dollars to the Federal debt. These provisions are narrowly crafted to hit only those who committed the worst abuses. . . . But for those few who have been at the helm of one of the worst financial scandals in history, the hit will be hard." *Gaubert*, 149 B.R. at 825, *citing* 136 Cong. Rec. H13,288; 13,289 (1990).

Felt asserts that since the AGI shareholders' losses in no way injured the Treasury of the United States, depleted any insurance fund for depositors, or affected

the loan portfolio or capital stock of an insured depository institution, his status as an "institution-affiliated party" should not create a fiduciary relationship between himself as a bank officer and the stock purchasers. Felt argues that the cases applying section 523(e) to an institution-affiliated party of an insured depository institution all deal with situations in which the institution itself was harmed by the party's conduct. *See, e.g., In re Gaubert*, 149 B.R. 819.

The OTS argues that Felt was acting in a fiduciary capacity for the purposes of section 523(a)(4) and 523(e). Because Felt was a director, officer, employee, and controlling shareholder of Reliance through 1986, he is within the definition of "institution-affiliated party." Felt was acting as a controlling shareholder when he sold his Reliance stock. The definition of "institution-affiliated party" in section 1813(u)(1) includes controlling shareholders. The plain language of the statute makes section 523(e) apply to Felt.

The OTS also argues that Felt was "involved in wrongful acts that jeopardized the financial health of an insured depository institution," making the application of section 523(e) consistent with the legislative history. (Docket Entry No. 5, at 15-16). The OTS disputes Felt's allegation that only the individual investors were harmed as a result of Felt's sale of Reliance stock in violation of the securities laws. The OTS alleges that Felt's material misrepresentations and omissions contained in the preliminary and final offering circulars may have subjected Reliance to tort liability and/or liability under Rule 10(b)(5), including possible liability as an aider and abettor. Felt had arranged the financing in a way that

deprived Reliance of the opportunity to use "pushdown" purchase accounting for Felt's sale, which cost Reliance the opportunity to report a positive capital position. (*Id.* at 16).

This court agrees that Felt's sale of the Reliance stock to investors, at a time when he was the controlling shareholder, president, and director, may have exposed Reliance to liability. Felt's argument that he was simply transacting business, in his personal capacity, in an "arms-length transaction" with the AGI investors is not well-taken. There may be situations in which an institution-affiliated party of an insured depositor institution engages in fraudulent behavior in a capacity separate and apart from that affiliation, such that applying section 523(e) would go beyond the proper scope of the statute. This is not that case.

No genuine issue of material fact exists as to the applicability of section 523(e) to Felt. This court DENIES Felt's third motion for summary judgment.

B. Felt's Fiduciary duty Under Section 523(a)(4)

Even if Felt were correct that section 523(e) did not apply, his debt is still nondischargeable under section 523(a)(4).

Felt argues that section 523(a)(4) does not apply to him because he was not acting "in a fiduciary capacity" with regard to the AGI shareholders. Felt directs this court's attention to cases limiting fiduciary relationships

under section 523(a)(4) to those arising out of a preexisting express or technical trust, rather than implied, resulting, or constructive trusts. *In re Johnson*, 108 B.R. 129, 132 (W.D. Tex. 1989).

However, recent Fifth Circuit case law has broadened the scope of fiduciary duty under section 523(a)(4) beyond technical trust relationships. *Matter of Moreno*, 892 F.2d 417, 421 (5th Cir. 1990) and *Matter of Bennett*, 989 F.2d 779, 787 (5th Cir. 1993), *cert. denied*, 114 S.Ct. 601 (1993) demonstrate that an officer of a Texas corporation owes a common law fiduciary duty to the corporation and its stockholders that satisfies section 523(A)(4).

Matter of Bennett decided an issue of first impression in the Fifth Circuit. At issue in *Bennett* was whether the scope of the fiduciary duty owed by the managing general partner of a limited partnership to the limited partners was sufficient to meet the requirements of section 523(a)(4). *Id.* at 783. Courts had divided over the requirement that there be a "technical trust" to satisfy section 523(a)(4). *Id.* at 784. Most courts had recognized that the "technical" or "express" trust requirement was not limited to trusts arising by a formal trust agreement, but included relationships in which trust-type obligations were imposed by statute or common law. *Id.* at 785, *citing Moreno v. Ashworth*, 892 F.2d 417, 421 (5th Cir. 1990).

The *Bennett* court analyzed the applicability of section 523(a)(4) in two steps. First, the court looked to Texas law to determine what obligations are imposed on managing general partners of a limited partnership with respect to limited partners. The court then decided whether the obligations imposed under the state law

were sufficient to meet the federal requirements of "fiduciary capacity" under section 523(a)(4). *Id.* at 785. In *Moreno,* the debtor had entered into self-dealing transactions as a corporate officer, and the resulting debts were not dischargeable under section 523(a)(4). *Moreno,* 892 F.2d at 421. The *Bennett* court relied on *Moreno* to decide that the duty of a managing partner of a limited partnership to the limited partners was a fiduciary duty under section 523(a)(4). *Bennett,* 989 F.2d at 787.

At the time Felt made material misrepresentations and omissions in his circulars, he was the president of AGI. He made these misrepresentations to the shareholders of AGI. The OTS alleges that Felt stood to benefit personally from the exchange, but he concealed this fact from the investor-shareholders. The exchange enabled Felt to comply with the FHLBB mandate that he transfer his Reliance stock. The exchange also made it possible for Felt to cancel AGI's investment debt, allowing Felt to avoid personal liability for AGI's financial difficulties. Felt could retain AGI's assets for himself, forgive his personal debt to AGI, and delay collection of AGI's loans. (Docket Entry No. 5, p.18).

Under *Bennett* and *Moreno,* Felt violated fiduciary duties under section 523(a)(4). No genuine issue of material fact exists as to the application of section 523(a)(4) to Felt.

IV. Conclusion

Felt never claims that he was not acting in his capacity as a institution-affiliated party, but rather that the statute was not meant to apply to such a case. This court

determines that under the plain language of the statute, section 523(e) does apply to Felt, and that he is a fiduciary for the purpose of section 523. Even if section 523(e) does not apply, Felt is still not subject to discharge because he was acting as a fiduciary under section 523(a)(4).

Felt's Third Motion for Partial Summary Judgment is DENIED.

V. Felt's Second Motion for Summary Judgment

This motion is addressed to the amount of indebtedness subject to discharge in Felt's bankruptcy proceeding. Felt claims that his indebtedness to the OTS is discharged as to all damages and interest attributable to shareholders who did not elect to participate in the judgment against Felt by the court-imposed deadline.

A. Background

A "Final Judgment and Permanent Injunction" was filed on January 9, 1991 in *FHLBB v. Felt*, No. H-88-1204. (Docket Entry No. 12, Ex. A). The "Final Judgment" stated that by February 28, 1991, the OTS was to send a copy to each person who purchased Reliance stock from Felt in December 1986, and whose purchase was reflected in the stockholder list. Each stockholder then had until September 1, 1991, to file a claim with the OTS for recissional damages of $10.00 per share of Reliance stock purchased. A stockholder who did not respond by September 1, 1991, lost further opportunity to participate in the judgment against Felt.

Felt contend that the OTS's list of shareholders who timely responded to the "Final Judgment Notice" represents only a portion of those eligible to participate in the judgment against Felt. Felt argues that the judgment is dischargeable as to actual damages, pre-judgment interest, and post-judgment interest attributable to stock sold to shareholders who failed to respond by the court-ordered deadline.

Felt refers to the Summary of Nonelecting Shareholders to demonstrate that 65 percent of the debt, or $2,778,710, plus pre-judgment and post-judgment interest has been left unclaimed by the Reliance stock purchasers. This summary lists all shareholders who owned Reliance stock on December 31, 1986. Felt multiplies the number of shares owned by each shareholder on the list by $10, the amount of recissional damages per share, and subtracts the amount attributable to the non-electing shareholders from the total judgment debt. (Docket Entry No. 12, Affidavit of Craig E. Power, p.2 at Ex. B).[1] The court finds

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[1] The OTS argues that because Felt moved for leave to file an amended answer adding his alleged entitlement to offsets or credits as an affirmative defense, and because that motion has not yet been decided, this court should not rule on the present motion until the previous motion is granted.

Felt pleaded in paragraph 30 of his Response to the First Amended Complaint for Determination of Nondischargeability of Debt that "OTS was awarded the money in trust only for those shareholders who agreed to participate in said judgment." (Docket Entry No. 9, p. 4). Felt asserts that if an affirmative pleading is necessary to raise this issue, he has raised it. In the alternative, Felt asserts that he does not have the burden of pleading this issue. The OTS, as trustee for the shareholders, filed with the trial court a list of electing shareholders after the

that Felt has raised this issue and that it is properly before this court.

The OTS claims that Felt has not carried his summary judgment burden because he has failed "to foreclose the possibility that one or more nonelecting shareholders transferred Reliance shares purchased on December 31, 1986 to electing shareholders before the close of the election period on September 1, 1991." (Docket Entry No. 3, p. 5). The OTS claims that the list of electing shareholders does not accurately indicate the number of shares held by those electing shareholders. Felt obtained the information to calculate the number of shares held by the electing shareholders from a copy of OTS's Securities Exhibit 9, which is as of December 31, 1986.[2] The OTS claims that Felt has failed conclusively to establish the number of shares held by the electing and nonelecting shareholders as of the close of the election period on September 1, 1991. Without current, accurate information, the OTS asserts that at a minimum, fact issues remain as to whether Felt is entitled to any offset or credit, or, if so, in what amount.

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entry of judgment against Felt. Because the judgment on its face awarded relief only to electing shareholders, Felt does not have the burden to plead that some shareholders did not acquire rights against Felt by assignment or inheritance.

[2] The OTS argues that because Felt earlier failed to admit the accuracy of the list of shareholders who purchased stock in response to a request for admission, Felt cannot now claim that the exhibit is authentic. However, the OTS used the same exhibit its own pleadings and admitted the accuracy of the exhibit as an authentic list of the shareholders as of December, 1986 in its motion for summary judgment in the underlying suit.

Felt has shown summary judgment evidence establishing the identities of the non-electing shareholders and the number of shares they held. Where the moving party has met its Rule 56(c) burden, the nonmovant cannot survive a motion for summary judgment by resting on the pleadings. *Little*, 37 F.3d at 1075, (*citing Celotex*, 106 S. Ct. at 2553-54). The nonmovant's burden is not satisfied with "some metaphysical doubt as to the material facts." *Little*, 37 F.3d at 1075 (*citing Matsushita*, 106 S. Ct. at 1356), or by "unsubstantiated assertions," "conclusory allegations," or a mere "scintilla" of evidence. *Little*, 37 F.3d at 1075 (citations omitted).

The OTS has alleged nothing more than unsubstantiated speculation of a "possibility" that one or more non-electing shareholders may have transferred Reliance stock to electing shareholders before the close of the election period on September 1, 1991. That possibility is not sufficient to preclude summary judgment.

Felt's Second Motion for Summary Judgment is GRANTED. The remaining motions, Docket Entry No. 6 and 7, are DENIED as moot.

The OTS has 10 days from the date the order is entered to submit a proposed final judgment consistent with this order or to identify any issues remaining in this case, with a brief description of the work required to resolve them and a proposed schedule for doing so.

SIGNED on September 21, 1995, at Houston, Texas.

/s/ Lee H. Rosenthal
Lee H. Rosenthal
United States District Judge

APPENDIX D

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

OFFICE OF THRIFT SUPERVISION	§	
Plaintiff,	§	CIVIL ACTION
VS.	§	NO. H-94-3979
DAVID J. FELT	§	Adversary No. 93-4416
Defendant.	§	

MEMORANDUM AND ORDER

(Filed Feb. 27, 1997)

This case arises from *Federal Home Loan Bank Board v. David J. Felt*, Civil Action No. H-88-1204. In that case, the district court found that David J. Felt ("Felt") had violated federal securities laws in the sale of his stock in Reliance Savings Association in 1986. The district court found that Felt had obtained approximately $4.5 million from 170 individuals by the sale of his Reliance stock. On December 30, 1990, the district court entered final judgment against Felt and in favor of the Office of Thrift Supervision ("OTS"), as trustee for the stock purchasers, in the principal amount of $4,271,120, plus prejudgment interest in the amount of $1,537,603.20, costs of suit, and post-judgment interest. The Fifth Circuit affirmed.

On September 1, 1992, Felt filed a petition under Chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the Southern District of Texas. That case was converted to a Chapter 7 proceeding. On July 8,

1993, the OTS filed an adversary proceeding to bar the discharge of the debtor, Felt, from the debt resulting from the district court judgment. After Felt filed a number of motions to dismiss that implicated the district court judgment, the order of reference was withdrawn. The parties then filed motions seeking summary disposition as to a number of issues in the case.

In September 1995, this court denied Felt's motion for partial summary judgment that he was not covered by the exception to discharge set out in sections 523(a)(4) and 523(3) of the Bankruptcy Code. This court granted Felt's motion for partial summary judgment that his debt was discharged as to damages and interest attributable to stock sold to shareholders who did not elect to participate in the judgment against Felt by the deadline imposed in the underlying case.

The OTS subsequently identified three remaining issues for decision: (1) whether the OTS lacks standing or authority to prosecute this action; (2) whether collateral estoppel bars the OTS from asserting that Felt's indebtedness is nondischargeable; (3) whether Felt should be granted leave to amend his complaint; and (4) whether Felt's breaches of fiduciary duty under 11 U.S.C. § 532(a)(4) were "willful" for the purpose of a finding of defalcation.[1]

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[1] This court notes that Felt has filed nothing to respond to the OTS's identification of issues.

I. Standing and Authority to Prosecute

This court has carefully reviewed Felt's arguments that the OTS lacked standing or authority to prosecute the underlying case and lacked standing or authority to protest Felt's attempt to discharge the judgment debt through filing bankruptcy. This court concludes that Felt's arguments are without merit. Felt asserted that the OTS was not a creditor under 11 U.S.C. §§ 101(10) and 523(c). The OTS responded and filed a cross-motion for partial summary judgment dismissing Felt's affirmative defense of lack of authority or standing to prosecute this proceeding.

The judgment in the underlying case, which has been affirmed by the Fifth Circuit, directed the OTS to collect the monetary judgment entered in its favor and against Felt, and to then "make a pro rata assignment of its interest in the judgment to all the stockholders who file a claim" by the specified date. The OTS is a "creditor," as defined by section 101(10)(A), that has a "claim" as defined by section 101(5)(A). The OTS has standing to prosecute this proceeding; it is a party with a right to receive payment on the judgment debt, that has been ordered by a final judgment to collect that debt. *See, e.g., In re Austin,* 138 B.R. 898 (Bankr. N.D. Ill. 1992); *In re Muller,* 111 B.R. 911, 913-914 (Bankr. S.D. Cal. 1990); *Matter of Springer,* 127 B.R. 702 (Bankr. M.D. Fla. 1991).

This court GRANTS the OTS's motion for partial summary judgment and dismisses Felt's affirmative defense that the OTS lacks standing or authority to prosecute this action.

II. The Preclusive Effect of the District Court's Judgment Against Felt

Felt asserts that the OTS is barred by collateral estoppel from asserting that Felt's judgment debt is nondischargeable. Felt argues that OTS's complaint in the district court set out two causes of action for misrepresentation. The district court's judgment, dated December 31, 1990, stated that Felt had violated "certain regulations," but contained no express findings or conclusions as to the OTS's causes of action for misrepresentation. Felt argues that the final judgment must therefore be read to adjudicate those causes of action in his favor, so that collateral estoppel would preclude the OTS from asserting those causes of action against Felt in this nondischargeability proceeding. (Docket Entry No. 55, pp. 10-11).

Felt's argument is unpersuasive. The final judgment entered by the district court does not reflect any determination of the OTS's causes of action for misrepresentation. Instead, the final judgment specifically states that it is based on a finding that Felt violated FHLBB regulations governing the sale of his Reliance stock. The Fifth Circuit has stated the standard for determining whether collateral estoppel should apply to a particular case:

> Collateral estoppel applies to bar litigation of an issue previously decided in another proceeding by a court of competent jurisdiction when four conditions are met: (1) the issue under consideration is identical to that litigated in the prior action; (2) the issue was fully and vigorously litigated in the prior action; (3) the issue was necessary to support the judgment in the prior

> case; and (4) there is no special circumstance that would make it unfair to apply the doctrine.

Copeland v. Merrill Lynch & Co., Inc, 47 F.d3 1415, 1421 (5th Cir. 1995) (citation omitted). Collateral estoppel does not preclude litigation of an issue unless both the facts and the legal standard used to assess them are in the same both proceedings. *Id.* at 1422 (citations omitted).

There is no basis for a conclusion that the OTS's causes of action for misrepresentation were necessary to support the judgment in the prior case. To the contrary, the record before this court shows that the district court in the underlying case found it unnecessary to determine the liability issues relating to the OTS's causes of action for misrepresentation. The prior judgment does not preclude the OTS from asserting that the judgment debt is nondischargeable in this case.

This court DENIES Felt's motion for partial summary judgment, and GRANTS the OTS's cross-motion for partial summary judgment, finding that collateral estoppel does not preclude the OTS's basis for asserting nondischargeability in this proceeding.

III. Felt's Motion for Leave to Amend his Answer

In the Bankruptcy Court, before the reference was withdrawn, Felt moved for leave to amend his answer in order to assert additional affirmative defenses. Felt filed his motion on September 29, 1994, after discovery had concluded. The OTS opposed the motion to the extent sought to raise affirmative defenses that had not previously been asserted and been the subject of discovery. Specifically, the OTS opposed Felt's motion for leave to

raise the affirmative defense that Felt had lacked the intent to defraud those to whom he sold his reliance stock. The OTS emphasized that it had conducted discovery in reliance on prior orders, agreed to by Felt, and signed by the bankruptcy Judge, setting out a procedure and a timetable for identification of and discovery in the parties' claims and defenses. The OTS also opposed Felt's motion for leave to add an affirmative defense that res judicata barred claims that had not been previously identified as precluded by the prior judgment, and to add a claim that the district court judgment is subject to offsets and credits, a defense that should have been raised before the court rendering that judgment.

Fed. R. Civ. P. 15(a) requires leave of the court for a party to file an amended pleading and provides that such leave "shall be freely given when justice requires." In deciding whether to grant leave to file an amended pleading, a district court may consider factors such as undue delay; bad faith or dilatory motive on the part of the movant; repeated failure to cure deficiencies by amendments previously allowed; undue prejudice to the opposing party; and futility of amendment. *See Foman v. Davis*, 371 U.S. 178, 182 (1962); *Wimm v. Jack Eckerd Corp.*, 3 F.3d 137, 139 (5th Cir. 1993). This court agrees that the OTS would be unfairly and severely prejudiced by the untimely motion filed by Felt. This court notes that Felt delayed filing his motion for leave until after discovery had concluded, even though he sought, and obtained, several extensions to the deadlines imposed by the Bankruptcy Court. Felt's motion for leave to amend is DENIED.

IV. The Issue of Willfulness under Section 523(a)(4)

The OTS raises the issue of whether the court's prior Memorandum and Order holds that Felt's violation of fiduciary duties under section 523(a)(4) was also a "willful" defalcation under the same statute. The OTS did not move for summary judgment as to this issue. However, the OTS did raise it in the September 1995 filing with this court. Felt has not filed any response. This court therefore proceeds to decide the issue.

Section 523(a)(4) excepts from discharge "any debt- . . . for fraud or defalcation while acting in a fiduciary capacity. . . . " "Defalcation" includes willful neglects of duty unaccompanied by fraud. *Matter of Davis*, 3 F.3d 113, 115 (5th Cir. 1993), *citing Matter of Moreno*, 892 F.2d 417, 421 (5th Cir. 1990). This court has found that based on the undisputed summary judgment evidence, Felt violated fiduciary duties owing to AGI and its shareholders. Felt violated his fiduciary duties when he offered AGI's investors Felt's Reliance stock, using an offering circular without obtaining the FHLBB's approval for the contents. The offering circular did not disclose that: Felt was obligated by the federal regulators to sell all his reliance stock by a certain date; a Felt-owned company would finance the purchases of approximately 33 percent of the stock on a nonrecourse basis, with no deposit; and Reliance was not entitled to use "pushdown" accounting and was insolvent without that accounting treatment. Felt's personal benefit from the exchange of his Reliance stock for the investors' AGI stock was not disclosed. The summary judgment evidence shows that as a result of the exchange, Felt complied with the FHLBB mandate that he transfer his Reliance stock; canceled AGI's investment debt,

allowing Felt to avoid personal liability for that debt; and allowed Felt to retain AGI's assets for himself and to forgive his personal debt to AGI. As a matter of law, Felt willfully neglected his fiduciary duties, rendering the debt nondischargeable under 11 U.S.C. § 523(a)(4).

V. Order

This court has resolved all outstanding motions and cross-motions and determined the issues necessary to final disposition. The OTS is ordered to submit a proposed final judgment within ten days from the date this order is entered.

SIGNED on February 25, 1997, at Houston, Texas.

/s/ Lee H. Rosenthal
Lee H. Rosenthal
United States
District Judge

APPENDIX E

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

OFFICE OF THRIFT SUPERVISION,	:	
Plaintiff,	:	CIVIL ACTION NO. H 94-3979
v.	:	Adversary No. 93-4416
DAVID J. FELT,	:	
Defendant.	:	

FINAL JUDGMENT

(Filed Mar. 21, 1997)

The first amended complaint of the Office of Thrift Supervision, seeking a determination that its debt evidenced by the Final Judgment and Permanent Injunction of this Court in *Federal Home Loan Bank Board v. David J. Felt*, Civil Action No. H-88-1204, is nondischargeable in bankruptcy, having come before the Court on the several dispositive cross-motions of the parties;

The Court having read and considered the papers filed and submitted in support of and in opposition to the parties' several dispositive cross-motions; and

The Court having issued its Memorandum and Order dated September 21, 1995 (filed of record on September 25, 1995) and its Memorandum and Order dated February 25, 1997 (filed of record on February 27, 1997);

IT IS DECLARATORILY ADJUDGED as follows:

1. That portion of the Final Judgment and Permanent Injunction of this Court in *Federal Home Loan Bank Board v. David J. Felt,* Civil Action No. H-88-1204, which awards damages of $2,778,710 plus pre-judgment and post-judgment interest on said amount to the Office of Thrift Supervision, as trustee, in connection with the December 1986 sale and purchase of those shares of the common stock of Reliance Savings Association, Houston, Texas to which the attached "SUMMARY OF NON-ELECTING SHAREHOLDERS" makes reference, is determined to be DISCHARGEABLE in bankruptcy; and

2. The remainder of the Final Judgment and Permanent Injunction entered by this Court in favor of the Office of Thrift Supervision, as trustee, in *Federal Home Loan Bank Board v. David J. Felt,* Civil Action No. H-88-1204, is determined to be NONDISCHARGEABLE in bankruptcy under and pursuant to 11 U.S.C. § 523(a)(4).

IT IS ORDERED that forthwith upon its receipt of a filed copy of this Final Judgment, plaintiff Office of Thrift Supervision shall serve copies of same upon Defendant David J. Felt simultaneously by first class mail, postage prepaid, and by certified mail, return receipt requested, addressed to both Post Office Box 22622, Houston, Texas 77227 and 720 Marchmont, Houston, Texas 77024 and shall promptly file proof of such service.

Signed on March 31, 1997, at Houston, Texas.

/s/ Lee H. Rosenthal
LEE H. ROSENTHAL
United States District Judge

SUMMARY OF
NONELECTING SHAREHOLDERS

SHAREHOLDER'S NAME	PAGE OF PX 9	SHARE CERT. NO.	NO. OF SHARES	NO. OF SHARES X 10,000
1. ALDRICH, DAVID C.	0000391	101	337	$ 3,370.
2. ALDRICH, LINDA S.	0000391	102	337	$ 3,370.
3. BAMBERG, GEORGE, et al.	0000391	104	1,159	$ 11,590.
4. BEDFORD, SEAN J.	0000391	109	382	$ 3,820.
5. BEIMGRABEN, OTTO	0000391	110	568	$ 5,680.
6. COLLIER, ROSE	0000392	120	144	$ 1,440.
7. DIEP, LOI	0000393	131	467	$ 4,670.
8. DORCEY, ALBERTA, et al.	0000393	132	212	$ 2,120.
9. EAGLE RIDGE ENTERPRISES	0000393	137	15,538	$155,380.
10. EARHART FRED	0000393	138	326	$ 3,260.
11. EMERSON, GARY	0000394	140, 141	6,889	$ 68,890.
12. EMERSON, PAULINE	0000394	142, 143	2,070	$ 20,700.
13. EVANS, BONNIE SUE	0000394	144	325	$ 3,250.
14. FIKE, RONALD E.	0000394	146	363	$ 3,630.
15. FRANCESCHI, MILICENT	0000394	148	269	$ 2,690.
16. FRANCESCHI, RENALDO	0000394	149	392	$ 3,920.
17. GORI, IMOGENE	0000395	162	203	$ 2,030.
18. GUZMAN, JOE, et al.	0000395	165	666	$ 6,660.
19. HAEDER, MARVIN	0000395	166	264	$ 2,640.
20. HALL & HALL	0000395	167	2,795	$ 27,950.
21. HAUSLER, JUDY ANN, et al.	0000396	172	893	$ 8,930.
22. HAUSLER, OSCAR, et al.	0000396	173	13,636	$136,360.
23. HAUSLER, OSCAR	0000396	174	4,349	$ 43,490.
24. HEAD, A.D. or HAUSLER, OSCAR	0000396	175	286	$ 2,860.
25. HOGAN, DEBBIE	0000396	180	2,287	$ 22,870.

26. IVES, J. HIETT, et al.	0000397	189	1,279	$ 12,790.
27. JOYCE, S. MARK	0000398	199	242	$ 2,420.
28. JOYCE, JANICE C.	0000398	200	194	$ 1,940.
29. KADLICK, DIANE P.	0000398	201	304	$ 3,040.
30. KADLICK, RICHARD J.	0000398	202, 203	529	$ 5,290.
31. LEWIS, LARRY, et al.	0000399	209	2,057	$ 20,590.
32. LORENZ, RUTH A.	0000399	213	475	$ 4,750.
33. LUNDE, HENRY J.	0000399	214	1,230	$ 12,300.
34. MAX, MAXINE, et al.	0000399	215	227	$ 2,270.
35. MATTLE, JR., EARL	0000399	220	285	$ 2,850.
36. MC LEOD, JANE K.	0000400	221	322	$ 3,220.
37. MEERS, STEVEN W.	0000400	222	3,784	$ 37,840.
38. MUKERJI, SANTOSH	0000400	230	330	$ 3,300.
39. MUTCHLER, ADELE C.	0000400	231	322	$ 3,220.
40. MUTCHLER, JOHN	0000400	232	322	$ 3,220.
41. MARTINEZ, OLYMPIO	0000401	238	384	$ 3,840.
42. O'DONNELL, J.M.	0000401	240	263	$ 2,630.
43. POPE, HAL	0000401	243	608	$ 6,080.
44. POPE, CHRISTINE	0000401	244	1,082	$ 10,820.
45. RAINBOLT, CAROL	0000401	243	739	$ 7,390.
46. RENFROE, HARRIS, et al	0000401	246	857	$ 8,570.
47. ROBBINS, FRANK	0000402	247	264	$ 2,640.
48. ROBBINS, JANET or FRANK	0000402	248, 249	773	$ 7,730.
49. ROSCA, MIRELLE	0000402	252	312	$ 3,120.
50. SALSER, ELDON or ANN MARIE	0000402	254	330	$ 3,300.
51. SIGMOND, DAVID	0000402	258	665	$ 6,650.
52. SPANGLER, MACON et al	0000403	260	1,723	$ 17,230.
53. STORMS, RANDOLF	0000403	262	648	$ 6,480.
54. THOMAS, EVELYN et al	0000403	265	1,948	$ 19,480.
55. TRGOVICH, M.A.	0000403	272	469	$ 4,690.

56. UDELL, ROBERT and LILLY	0000404	273	27,020	$270,200.
57. WARLICK, C.E. or SHIRLEY	0000404	274	3,761	$ 37,610.
58. WATSON, VELINDA	0000404	275	632	$ 6,320.
59. WERNER, ALICE	0000404	276	405	$ 4,050.
60. WERNER, JAMES	0000404	277	405	$ 4,050.
61. WIEDERHALL, A. or H.	0000404	281	1,054	$ 10,540.
62. WRIGHT, GAIL	0000404	283	250	$ 2,500.
63. ZISSA, ANGELINE or ANFONS	0000404 and 0000405	285, 286	6,915	$ 69,150.
64. ZUNIGA, JUAN or JOSEFINA	0000405	287	860	$ 8,600.
65. DRULEY, JOHN D.	0000405	288	14,800	$148,000.
66. MEEKS, RANDALL C.	0000405	289	14,500	$145,000.
67. GOLDMAN, ARTHUR	0000405	290	21,200	$212,000.
68. DAVIS, K.U.	0000405	292	19,726	$197,260.
69. LEWIS, JOHN R.	0000405	293	28,500	$285,000.
70. GUBITZ, STEPHEN P.	0000405	294	15,000	$150,000.
71. SPURLIN DEVELOP.	0000405	295	5,000	$ 50,000.
72. SILIVERMAN, STANLEY	0000405	296	14,500	$145,000.
73. BOYAR, J. WILLIAM	0000405	297	7,500	$ 75,000.
74. DANNATT, ALLAN	0000406	300	12,500	$125,000.
75. SHERBORNE, JANE	0000406	306	570	$ 5,700.
76. SHERBORNE, WILLIAM	0000406	307	570	$ 5,700.
77. THAKUR, SANESH	0000406	308	682	$ 6,820.
78. THAKUR, PUSHKA	0000406	309	87	$ 870.
79. SRJ TRUST	0000406	310	2,500	$ 25,000.
80. REINHART, H.J.	0000406	313 314	808	$ 8,080.
TOTAL				2,778,710

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APPENDIX F

IN THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF TEXAS HOUSTON DIVISION

IN RE: DAVID J. FELT, Debtor,	§	Civil Action No. H-94-3979
OFFICE OF THRIFT SUPERVISION, Plaintiff,	§	Bankruptcy No. 92-47538-H5-7
v.	§	Adversary No. 93-4416
DAVID J. FELT, Defendant.	§	

MEMORANDUM AND OPINION

(Filed June 29, 2000)

Plaintiff, the Office of Thrift Supervision ("OTS"), seeks a declaratory judgment that a federal court money judgment it obtained in 1990 against defendant, David J. Felt, is not dischargeable in bankruptcy. Pending before this court is the OTS's motion for summary judgment that Felt committed defalcation while acting in a fiduciary capacity, by willfully violating his fiduciary duties, within the meaning of 11 U.S.C. § 523(a)(4). Felt has responded by filing an opposition to the motion for summary judgment and by moving to withdraw or amend a deemed admission. (Docket Entry No. 37). Felt asserts that the record discloses disputed fact issues material to determining whether his conduct met the requirement of willfulness under section 523(a)(4).

Based on a careful review of the pleadings, submissions, and the applicable law, this court GRANTS the OTS's motion for summary judgment and also GRANTS Felt's motion to withdraw or amend the deemed admission. The grant of summary judgment makes Felt's liability to eligible claimants for the money judgment nondischargeable in bankruptcy. The reasons for these rulings are set forth below.

I. Factual and Procedural Background

In 1985, Felt purchased all the issued and outstanding stock of Bowie County Savings and Loan Association and became its president, chairman of the board, director, and chief executive officer. Felt moved the Bowie County Savings and Loan Association to Houston and changed its name to Reliance Savings Association ("Reliance"). In April 1986, the Federal Home Loan and Bank Board ("FHLBB") sought Felt's removal as Reliance's president and chairman, based on a transaction in which a wholly-owned Reliance subsidiary purchased two loans from American Guaranty, Inc. ("AGI"), a company Felt also owned and of which he was president.

In June 1986, Felt and the FHLBB entered into an agreement under which Felt agreed to sell his Reliance stock holdings within six months, subject to the FHLBB's approval of the transaction, or, if he could not meet the deadline, to transfer the stock to a trustee. Reliance consented to a cease and desist order. The FHLBB Office of Enforcement agreed to accept Felt's stock sale or transfer in lieu of a removal and prohibition order. Felt signed an August 29, 1986 Letter Agreement setting out these terms.

The Letter Agreement provided in part that "[u]pon FHLBB approval of the purchasers' application . . . or transfer of . . . shares to a trustee, . . . [Felt] shall not thereafter serve as a director, officer, agent or employee of Reliance. . . . " (Docket Entry No. 5, Tab 4).

In September 1986, Felt sent AGI investors a letter describing AGI's financial difficulties. In the letter, Felt offered to sell his own Reliance stock in exchange for the investors' AGI notes. With the letter, Felt included a 72-page Preliminary Offering Circular. The Circular portrayed the condition of Reliance's finances as sound. (*Id.*, Tab 2, p. 9). In the Circular, Felt told the prospective purchasers of his Reliance stock that, applying purchase and pushdown accounting to the sale of the Reliance stock or its exchange for AGI stock, the stockholder equity of Reliance would be $4.5 million.[1] Felt did not disclose in the Preliminary Offering Circular that federal regulators had required him to sell or transfer all his Reliance stock by March 1, 1987 and dissociate himself from Reliance. Felt did not disclose the cease and desist order applicable to Reliance. Nor did Felt disclose the fact that another company Felt owned, Specialty Finance Co., would finance investors' purchases of nearly thirty-three percent of Felt's Reliance stock, on a nonrecourse basis, with no deposit required. (*Id.*, Tabs 2, 8, 10, 11). Felt, the sole owner and manager of Specialty Finance Co., does

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[1] Under purchase and pushdown accounting, the assets and liabilities of a company are marked to market price and the amount paid for the company's stock is "pushed down" to the balance sheet to arrive at the net worth. The company's goodwill is increased to compensate for the difference.

not dispute that he had full knowledge of Specialty Finance's role in the proposed purchases of his stock and the terms of the financing. Felt does not dispute the OTS's summary judgment evidence that Felt created Specialty Finance Co. for the purpose of financing investors' acquisition of part of his Reliance stock. (Docket Entry No. 44, Tab 6).

Felt had provided Reliance's outside auditors, Peat, Marwick, Main & Co., with the Preliminary Offering Circular and asked them to provide an opinion to be included in the final offering documents. Peat Marwick declined to do so. In November 1986, following its audit of Reliance's June 30, 1986 unaudited financial statements, Peat Marwick refused to issue an opinion as to whether those statements met generally accepted accounting principles, citing as the reason Reliance's failure to provide the auditors with information necessary to make that determination. (Docket Entry No. 35, Tab C, p. 114-115).

On December 22, 1986, Felt sent the Final Offering Circular to potential investors. Felt did not, however, submit the Circular to the FHLBB, stating in the Circular that he had determined that prior FHLBB approval was not necessary. The Final Offering Circular repeated the statement in the Preliminary Offering Circular that push-down accounting would apply to make the post-sale shareholder equity in Reliance $4.5 million. (Docket Entry No. 5, Tab 11).

On December 31, 1986, Felt sold and transferred all 450,000 shares of his Reliance stock, at a price of $10 per

share. (*Id.*, Tab 12, ¶ 3). The record discloses that approximately 150 AGI investors exchanged their AGI notes and received approximately sixty percent of the Reliance stock. (*Id.*, Tab 3, ¶ 28). Five investors paid Felt approximately $400,000 in cash to purchase his Reliance stock. (*Id.*, ¶ 40). Eight investors bought approximately thirty-three percent of Felt's Reliance stock, through non-recourse loans obtained from Specialty Finance Company, with no initial payment required, and with the Reliance stock as the only collateral for the loan.

Reliance issued unaudited financial statements as of December 31, 1986 that used pushdown accounting to report the stock transactions. Those statements showed that Reliance had a net worth of $4.5 million. However, the FHLBB and Peat Marwick later determined that the stock transactions did not qualify for pushdown accounting treatment. More than ten percent of the stock sale was financed by an entity affiliated with the seller, precluding the application of pushdown accounting. (*Id.*, Tab 6, ¶ 2). Moreover, as the FHLBB concluded, Felt's transfer of Reliance stock to the AGI noteholders in exchange for their notes was not an arms-length transaction, given the prior relationships among AGI, Reliance, and Felt. The FHLBB required Reliance to issue revised financial statements presented on a historical cost basis. The revised financial statements showed that as of December 31, 1986, Reliance was insolvent. It had a negative net worth of $5.6 million, rather than the positive net worth of $4.2 million Felt had described in the Offering Circular as the post-sale value, using pushdown accounting. (*Id.*, Tab 16).

In April 1988, the FHLBB filed suit in federal court in the Southern District of Texas, seeking to rescind Felt's

sales of the Reliance stock. *Federal Home Loan Bank Board v. David J. Felt,* Civil Action No. H-88-1204. The district court judge found that Felt had violated federal securities laws by failing to secure the FHLBB's approval before distributing the Preliminary Offering Circular for the proposed sale of the Reliance stock. Following an evidentiary hearing, the district court found that Felt had obtained $4.5 million from approximately 170 individuals by selling them Reliance stock that was worthless when sold. The court found that when Felt sold his stock, he knew, or reasonably should have known, the facts and circumstances that led Peat Marwick to conclude that pushdown account was inappropriately used and led the FHLBB to require Reliance to reverse its pushdown accounting entries and reveal its insolvent status. (Docket Entry No. 5, Tab 15, p. 97).

On December 30, 1990, the district court entered final judgment against Felt and in favor of the OTS, as trustee for the stock purchasers, in the principal amount of $4,271,120, plus costs, prejudgment interest, and post-judgment interest. (Docket Entry No. 2, Ex. A). The Fifth Circuit affirmed that judgment on appeal.

On September 1, 1992, Felt filed a petition to reorganize under Chapter 11 in the United States Bankruptcy Court for the Southern District of Texas. *See Office of Thrift Supervision v. Felt (In re Felt),* Bankruptcy Case No. 92-47538-H5-7. The case was converted to a Chapter 7 proceeding. On July 8, 1993, the OTS initiated an adversary proceeding to seek a declaratory judgment that the money judgment it had obtained against Felt in the earlier federal case was nondischargeable under 11 U.S.C.

§ 523(a)(4), because the debt arose from Felt's defalcation while acting in a fiduciary capacity.[2]

On September 21, 1995, this court denied Felt's third motion for partial summary judgment, ruling that for the purpose of sections 523(a)(4) and (e), Felt was in a fiduciary relationship with the prospective stock purchasers, the noteholders of AGI, when Felt distributed the Preliminary Offering Circular. On the same date, this court granted Felt's second motion for partial summary judgment. In that motion, Felt challenged the amount of indebtedness subject to discharge. This court determined that, as a matter of law, Felt's indebtedness to the OTS was discharged as to the damages and interest attributable to shareholders who did not elect to participate in the judgment against Felt by the court-imposed deadline. The damages and interest discharged amounted to $2,778,710. (Docket Entry No. 20).

On February 25, 1997, this court granted the OTS's motion for partial summary judgment and dismissed Felt's affirmative defense that the OTS lacked standing or authority to prosecute this action. This court also denied Felt's partial summary judgment motion and granted the OTS's cross-motion for partial summary judgment with respect to the preclusive effect of the prior proceeding against Felt. This court also rendered summary judgment in favor of the OTS on the issue of nondischargeability,

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[2] The statute provides: "A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt . . . for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny . . . " 11 U.S.C. § 523(a)(4).

finding that Felt's conduct constituted defalcation in a fiduciary capacity under 11 U.S.C. § 523(a)(4) and (e). This court held that, based on the undisputed evidence disclosed in the record, Felt willfully neglected his fiduciary duties by failing to disclose material information in the Preliminary Offering Circular he used to sell his Reliance stock. Felt's material misrepresentations included his failure to disclose that federal regulators had previously forced him to sell all his Reliance stock; his failure to disclose that a company he owned would finance the purchase of thirty-three percent of the Reliance stock on a nonrecourse basis with no cash payment required; his failure to disclose that Reliance was insolvent; and his statement that Reliance would have a post-sale stockholder value of $4.5 million. (Docket Entry No. 22).

On appeal, the Fifth Circuit did not address the factual findings or legal conclusions this court reached except as to one issue. The Fifth Circuit ruled that this court should have given Felt ten days notice to supplement the record before entering partial summary judgment on the issue of willfulness as an element of defalcation. The Fifth Circuit remanded the case to permit this court to consider additional evidence Felt wished to submit and determine whether, given all the summary judgment evidence, a reasonable fact-finder could conclude that Felt was not willful.

On remand, the OTS has moved for summary judgment on the issue of willfulness. The OTS relies in part on Felt's answer to a request for admission. Felt has responded to the motion for summary judgment and has moved to withdraw or amend his answer to the request

for admission. (Docket Entry No. 37). The record is now supplemented and ready for ruling.

II. The Summary Judgment Standard

Summary judgment is appropriate if no genuine issue of material fact exists and the moving party is entitled to judgment as a matter of law. *See* FED. R. CIV. P. 56. Under FED. R. CIV. P. 56(c), the moving party bears the initial burden of "informing the district court of the basis for its motion, and identifying those portions of [the record] which it believes demonstrate the absence of a genuine issue of material fact." *Celotex Corp. v. Catrett*, 477 U.S. 317, 323 (1986); *Norman v. Apache Corp.*, 19 F.3d 1017, 1023 (5th Cir. 1994). The party moving for summary judgment must demonstrate the absence of a genuine issue of material fact, but need not negate the elements of the nonmovant's case. *See Little v. Liquid Air Corp.*, 37 F.3d 1069, 1075 (5th Cir. 1994) (en banc). If the moving party fails to meet its initial burden, the motion for summary judgment must be denied, regardless of the nonmovant's response. *See id.*

When the moving party has met its Rule 56(c) burden, the nonmovant cannot survive a motion for summary judgment by resting on the mere allegations of its pleadings. *See McCallum Highlands, Ltd. v. Washington Capital Dus, Inc.*, 66 F.3d 89, 92 (5th Cir. 1995). The nonmovant must go beyond the pleadings and designate specific facts showing that there is a genuine issue for trial. *See Little*, 37 F.3d at 1075 (citing *Celotex*, 477 U.S. at 325).

"[W]hen a district court denies a motion for summary judgment on the basis that there exist genuine issues of material fact, the district court is actually making two separate conclusions: 'First, the court has concluded that the issues of fact in question are genuine, i.e., the evidence is sufficient to permit a reasonable factfinder to return a verdict for the nonmoving party. Second, the court has concluded that the issues of fact are material, i.e. resolution of the issues might affect the outcome of the suit under governing law.' " *Lemoine v. New Horizons Ranch & Ctr., Inc.*, 174 F.3d 629, 633 (5th Cir. 1999) (quoting *Colston v. Barnhart*, 146 F.3d 282, 284 (5th Cir. 1998)).

In deciding a summary judgment motion, "[t]he evidence of the nonmovant is to be believed, and all justifiable inferences are to be drawn in his favor." *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 255 (1986). "Rule 56 '*mandates* the entry of summary judgment, after adequate time for discovery, and upon motion, against a party who fails to make a showing sufficient to establish the existence of an element essential to that party's case, and on which that party will bear the burden of proof at trial.' " *Little*, 37 F.3d at 1075 (quoting *Celotex*, 477 U.S. at 322).

III. The Motion for Summary Judgment

The OTS seeks summary judgment on the issue of the nondischargeability of Felt's judgement debt under 11 U.S.C. § 523(a)(4). Section 523(a)(4) states that the provisions of the Bankruptcy Code do not discharge a debtor from "any debt . . . for fraud or defalcation while acting in a fiduciary capacity. . . . " 11 U.S.C. § 523(a)(4).

A. The Deemed Admission

The OTS relies in part on Felt's response to Request Number 29 in the plaintiff's Sixth Request for Admissions. Request Number 29 reads: "The debt created by Paragraph No. 3 of the Final Judgment and Permanent Injunction in the District Court Litigation is for fraud while acting in a fiduciary capacity, within the meaning of 11 U.S.C. § 523(a)(4)." (Docket Entry No. 35, Tab F, p. 265-266). Felt failed to answer this request. Under F.R.C.P. 36, this request is deemed admitted. The OTS relies on this deemed admission to support its motion for summary judgment.

In response, Felt has moved to amend or withdraw that admission. *American Auto Ass'n (Inc.) v. AAA Legal Clinic of Jefferson Crooke, P.C.* sets out two criteria a court should weigh in determining if a party should be allowed to amend an admission: "The presentation of the merits must be subserved by allowing withdraw or amendment"; and "the party that obtained the admissions must not be prejudiced in its presentation of the case by their withdrawal." 930 F.2d 1117, 1119 (5th Cir. 1991). A district court has discretion as to whether a party should be permitted to withdraw or amend an admission. *Id.*

In this case, the OTS will not be prejudiced by the withdrawal; it did not rely solely on the admission in the discovery or motions processes. Discovery proceeded well beyond the date of the deemed admission. The parties conducted extensive discovery into Felt's conduct. Felt, as well as other parties, gave numerous depositions as to the transactions; covering Felt's relationship to the

companies and their relationships to him; the disclosures; and the use of pushdown accounting. The OTS has ample information of a substantiative nature on which to base its motion for summary judgment. Allowing withdrawal will serve the merits of this case because the deemed admission goes squarely to the willfulness issue. This court grants the motion to withdraw the deemed admission.

B. The Issue of Defalcation and Willfulness

Felt presents two arguments on remand: (1) based on the undisputed facts, his conduct does not amount to the type of breach of fiduciary duty that amounts to defalcation, as a matter of law; and (2) there are material fact issues as to whether Felt acted with the willfulness necessary for defalcation, precluding the grant of summary judgment on nondischargeability.

1. *The Nature of the Fiduciary Breach under Section 523(a)(4)*

Despite the fact the term has been used for over 150 years, defalcation "does not have a precise definition and no legislative history or comment exists to aid the interpretation." *Andy Warhol Foundation for Visual Arts, Inc. v. Hayes (In re Hayes)*, 183 F.3d 162, 171 (2nd Cir. 1999) (quoting *In re Twitchell*, 72 B.R. 431, 434 (Bankr.D. Utah 1987), *rev'd*, 91 B.R. 961 (D. Utah 1988), *rev'd*, 892 F.2d 86 (10th Cir. 1989)). Felt asks this court to limit the type of conduct that qualifies as defalcation as used in section 523 (a)(4) to the "misappropriation of trust funds held in

a fiduciary capacity, and failure to properly account for trust funds." (Docket Entry No. 39, p. 16). Felt relies upon *In the Matter of Garver*, 116 F.3ed 176, 179 (6th Cir. 1997)), to support this definition of defalcation. Felt argues that under this narrow definition, "[t]he mere failure to meet an obligation while acting in a fiduciary capacity simply does not rise to the level of defalcation; an express or technical trust must be present." (*Id.*, p. 13).

In *In re Garver*, 116 F.3d 176 (6th Cir.1997), the court addressed whether a state court judgment finding a lawyer liable for legal malpractice in connection with a business transaction the lawyer had proposed to his client was dischargeable under section 523(a)(4). The Sixth Circuit held that the state court judgment was not the result of defalcation under the Code. The court reasoned that a lawyer's breach of his general fiduciary duties to treat a client with utmost fairness was insufficient to trigger the defalcation provision of section 523(a)(4). The court adopted a definition of fiduciary relationship under section 523(a)(4) as limited to those situations in which an express or technical trust relationship arose from the placement of a specific res in the hands of the debtor, and the debtor misappropriated or failed properly to account for the trust funds he received. In *Garver*, although the parties had agreed that the debtor/lawyer was in a fiduciary relationship under section 523(a)(4), his "mere failure to meet an obligation" while acting in that general fiduciary relationship was not enough for defalcation. Instead, the court reasoned, the debtor/lawyer would have to misappropriate or fail to account for the funds he held as a result of a technical or express trust, not merely

provide legal advice that led to the loss of funds in what turned out to be a poor investment. 116 F.3d at 179-180.

The Fifth Circuit analyzed the type of fiduciary breach that triggers the defalcation provision of section 523(a)(4) in *In re Schwager*, 121 F.3d 177, 186 (5th Cir. 1997). This circuit held that fiduciary relationship required under the defalcation provision of section 523(a)(4) applies to "technical or express trusts," not to those trusts which the law implies from a contract. *Id.*, citing *In re Angelle*, 610 F.2d 1335 (5th Cir.1990). The trust relationship must exist prior to the act creating the debt, without reference to that act. *In re Bennett*, 989 F.2d 779, 784 (5th Cir.1993). However, relationships in which trust-type obligations are imposed by statute or common law qualify under this narrow standard. *Schwager*, 121 F.3d at 186, *citing Bennett*, 989 F.2d at 785.[3] Fraud, misappropria-

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[3] The case law discloses a lack of uniformity among the circuits. In *The Andy Warhol Foundation for Visual Arts, Inc. v. Hayes (In re Hayes)*, 183 F.3d 162 (2d Cir.1999), the Second Circuit, noting that the precise meaning of defalcation is unclear, cited *Central Hanover Bank & Trust Co. v. Herbst*, 93 F.2d 510 (2d Cir.1937). Judge Hand's decision stated:

> We do not hold that no possible deficiency in a fiduciary's accounts is dischargeable . . . we said that 'the misappropriation must be due to a known breach of the duty, and not to mere negligence or mistake.' Although that word probably carries a larger implication of misconduct than 'defalcation,' 'defalcation' may demand some portion of misconduct; we will assume arguendo that it does. All we decide is that when a fiduciary takes money upon a conditional authority which may be revoked and knows at the time that it may, he is guilty of a 'defalcation' though it may not be a 'fraud,' or an

tion, and embezzlement are not required elements of defalcation. *Id.*, 121 F.3d at 186.

Even under the narrow standard of the breach of fiduciary duties that the Fifth Circuit has announced, Felt's duties to the AGI noteholders and to Reliance, and his breaches of those duties, fall within the definition. It is undisputed that Felt was the president, chairman of the board, chief executive officer, and director of Reliance, engaged in selling the stock he owned in Reliance to investors in another company he owned, financed in part by another company he owned. Felt does not dispute that as a director and officer and majority shareholder, he owed fiduciary duties to AGI, its investors, and to Reliance. *Pepper v. Litton*, 60 S.Ct. 238 (1939) ("A director

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> 'embezzlement,' or perhaps not even a 'misappropriation.'

Id. at 512. The Second Circuit in *Hayes* referenced the *Central Hanover* decision, but did not define defalcation specifically. *See Hayes*, 183 F.3d at 172. The court noted the split of authorities as to the extent of misconduct required for defalcation under the statute.

The Second Circuit stated that, based on the facts of the case, "even assuming, as did Judge Hand, that defalcation demands 'some portion of misconduct,' we hold that Hayes committed a defalcation." *Id.* The Second Circuit noted that the debtor's conduct was "inconsistent with his obligation to deal fairly, albeit at a profit to himself, with the estate in establishing a fee arrangement because there was no attempt to match fees and the value of services – even to the extent of imposing a cap on the fees." *Id.* at 173. The Second Circuit concluded by stating that "[o]n the facts and circumstances presented, we therefore conclude that Haye's conduct was sufficiently at odds with his fiduciary obligations to constitute a defalcation within the meaning of Section 523(a)(4)." *Id.*

is a fiduciary. So is a dominant or controlling stockholder or group of stockholders. Their powers are powers in trust."); cited in *Fidelity & Dep. Co. of Md. v. USA Form Hail Pool, Inc.*, 523 F.2d 744, 760 (5th Cir.1975); *See also in re Moreno*, 892 F.2d 417, 421 (corporate officer owed a common law fiduciary duty to corporation and stockholders). The Fifth Circuit has found defalcation arising from misconduct by corporate fiduciaries. *Schwager*, 121 F.3d at 180 (managing partner in limited partnership breached fiduciary duty to the limited partners); *In re Moreno*, 892 F.2d 417, 422 (5th Cir.1990) (corporate president improperly took cash advances from the company); *In re Davis*, 3 F.3d 113, 115 (5th Cir.1993) (majority shareholder had improperly received informal dividends to the exclusion of the minority shareholder); *Bennett*, 989 F.2d at 782 (general partner of a limited partnership wrongfully charged the limited partnership for expenses that should have been charged to the partnership).

Felt relies on *Moreno v. Ashmorth (In re Moreno)*, 892 F.2d 417, 422 (5th Cir.1990) and *Sheerin v. Davis (In re Davis)*, 3 F.3d 113, 115 (5th Cir.1993), to limit the type of breach of fiduciary duties that will rise to the level of defalcation to acts of financial misappropriation of funds held in an express or technical trust. These cases do not support the narrow application Felt seeks. In *Moreno*, the president "directed the transfer of nearly $200,000 to himself and companies in which he owned a 50% or greater interest." 892 F.2d at 421. Although the court found that Moreno lacked fraudulent intent, the court nevertheless labeled Moreno's behavior as defalcation that precluded discharge of the judgment debt because his position carried with it the responsibility "not to lend [the company's]

money to himself or corporations controlled by him on less than an arm's length basis." *Id.* In *Davis*, a majority shareholder had sought to freeze out the minority shareholder. The judgment debt arose from the jury's finding that the majority shareholder conspired to deprive the minority shareholder of his stock ownership, and that the majority shareholder received informal dividends by making profit sharing contributions for his own benefit and to the exclusion of the minority shareholder. The Fifth Circuit held that the resulting judgment debts were nondischargeable under section 523(a)(4) because they were "willful acts by [the majority shareholder] contrary to his fiduciary obligations as an officer of the . . . Company." 3 F.3d at 116. Neither *Schwager*, *Moreno*, nor *Davis* precludes the application of section 523(a)(4) to the facts of this case.

Felt clearly owed fiduciary duties to the AGI stockholders, to AGI, and to Reliance, which the summary judgment record established that he breached. Felt argues that his breaches of fiduciary duty were mere "dereliction[s] of duty . . . , unaccompanied by [financial misconduct]. . . . " (Docket Entry No. 39, p. 16). His characterization is unpersuasive. The undisputed facts as to Felt's conduct include that neither in the Preliminary Offering Circular, nor in the Final Offering Circular, nor in other documents or statements, did Felt disclose the circumstances under which he had to sell his Reliance stock; the fact that Reliance was subject to a cease and desist order; or the personal benefits Felt would obtain from the transactions. Nor did Felt disclose the fact that another company he owned, Specialty Finance Co., would finance the purchase of approximately thirty-three

percent of his Reliance stock, on a nonrecourse basis, with no cash payment required. Nor did Felt disclose that the transactions precluded, or could preclude, the use of pushdown accounting and that, if pushdown accounting could not be applied, Reliance was already insolvent and the stock the purchasers were acquiring from Felt was worthless. (Docket Entry No. 22). To the contrary, Felt informed his prospective purchasers in the Preliminary and Final Offering Circulars that pushdown accounting was appropriately applied and that Reliance would have a positive net worth of $4.5 million after the sale.[4] When the sale was complete, and the pushdown accounting reversed, the approximately 170 purchasers had worthless Reliance stock. Felt, by contrast, received $400,000 in cash; AGI's stock and assets; the cancellation of AGI's investment debt; and the ability to forgive his own personal debt to AGI. (Docket Entry No. 5, p. 18).

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[4] Felt argues that he made no misrepresentations in the Offering Circulars because the pushdown accounting entries were not reversed until after the sales occurred. Felt's argument does not take into account the evidence in the summary judgment record showing that at the time Felt prepared and distributed the Offering Circulars, the facts and circumstances of the proposed transactions precluded the application of pushdown accounting. Although Peat Marwick did not disallow the accounting treatment until after the sale, it was on the basis of facts existing at the time the circulars were prepared. Felt's argument also fails to take into account the fact that Felt did more than simply represent that pushdown accounting might be available. The statements in the Offering Circulars told prospective investors that pushdown accounting was appropriately applied and resulted in a positive post-sale net worth for Reliance of $4.5 million. Felt did not disclose that absent pushdown accounting, Reliance was worthless.

The conduct disclosed in this record is significantly more than the conduct the Sixth Circuit rejected as insufficient for defalcation in *In re Garver*, in which a lawyer provided advice to a client about a business venture that turned out to be a poor investment. 116 F.3d at 180. The facts as to Felt's conduct do not amount to a "mere dereliction of duty, unaccompanied by financial misconduct." Felt's conduct is within the standard the Fifth Circuit announced in *Schwager* or other cases. The definition Felt advocates for the type of breach necessary to constitute defalcation, or "financial misconduct" of specific trust funds, is so narrow that as applied to the facts of this case, it would require a showing of embezzlement or fraud. That is not the law in this circuit. To the contrary, defalcation clearly applies to conduct that does not reach that level. *In re Schwager*, 121 F.3d at 184. Felt's argument that his conduct cannot constitute defalcation under section 523(a)(4) is without merit.

2. Willfulness in the Breach of Fiduciary Duties

Felt contends that the record shows disputed facts material to determining whether he had the requisite mental state of defalcation, precluding summary judgment. the OTS contends that the undisputed facts show Felt's willfulness as a matter of law.

The Fifth Circuit requires willfulness in the breach of a fiduciary duty to commit defalcation under section 523(a)(4). *In the Matter of Schwager*, 121 F.3d at 185.[5] In

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[5] Other courts have imposed a significantly lower standard of mental culpability on a debtor/fiduciary whose debt is held

Schwager, the Fifth Circuit addressed the type of intent or mental state necessary under section 523(a)(4). *Schwager*, 121 F.34d at 185. The court recognized that "[a]as an initial matter, it is clear that defalcation requires a lesser standard than fraud, and thus defalcation does not require actual intent, as does fraud." *Id., citing Central Hanover Bank & Trust Co. v. Herbst*, 93 F.2d 510, 512 (2d Cir.1937). The court went on to state that while defalcation does not require "actual intent, it does require some level of mental culpability." *Id.* The court concluded: "It is clear in the Fifth Circuit that a 'willful neglect' of fiduciary duty constitutes a defalcation – essentially a recklessness standard." *Id.*, n. 12. The *Schwager* court referred to the definition of "willful misconduct" as "a conscious, intentional failure or reckless indifference," and declined to extend defalcation to include merely negligent conduct. *Id.; see also, Davis*, 3 F.3d at 116; *Moreno*, 892 F.2d at 421; *Meyer*, 36 F.3d at 1385.

The OTS asserts that the undisputed facts show that Felt willfully neglected his fiduciary duties by failing to obtain FHLBB approval of the Preliminary and Final Offering Circulars and by making material omissions and misrepresentations in the Offering Circulars. Responding

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nondischargeable under section 523(a)(4). See, e.g., *Storie v. Antler Roof & Builders Supply (In re Storie)*, 216 B.R. 283, 288-289 (B.A.P. 10th Cir. 1997); *Carey Lumber Co. v. Bell*, 615 F.2d 370, 376 (5th Cir. 1980); *Zohlman v. Zoldan*, 226 B.R. 767, 777 (S.D.N.Y.1998); *American Honda Finance Corp. v. Francis*, 1993 WL 208236, *3 (W.D. Va. 1993); *Comm'r of Ins. of P.R. v. Valle Otero (In re Valle Otero)*, 174 B.R. 873, 881 (Bankr.D.P.R. 1994); *Landvest Assoc. v. Owens (In re Owens)*, 54 B.R. 162, 165 (Bankr.D.S.C. 1984).

to the first argument, Felt disputes that he knew that he had to obtain FHLBB approval; he asserts that he believed his Letter Agreement with the FHLBB was "void." (Docket Entry No. 39). It is undisputed that Felt and the FHLBB executed the Letter Agreement; Felt's signature appears on the document. Felt contends that after the parties signed the Letter Agreement, he sought clarification of certain issues, to which the FHLBB objected. Felt argues that as a result, he viewed the entire Letter Agreement as void.

The undisputed facts in the record do not support this argument. Although the FHLBB objected to certain parts of Felt's Letter of Clarification, Felt himself conceded in the Letter of Clarification that he was obligated to seek FHLBB approval of the Offering Circular. Felt again acknowledged his obligation to obtain FHLBB approval in an October 23, 1986 letter to the FHLBB Office of Enforcement, in which he stated, "I expect to complete a sale of the stock this year subject to FHLBB approval." (Docket Entry No. 35, Tab F, p. 149). Felt wrote this letter to the Office of Enforcement over a month after the FHLBB objected to Felt's Letter of Clarification. The undisputed evidence in the record establishes that Felt recklessly disregarded his obligation to seek and obtain FHLBB approval of his Offering Circular.

Felt responds to the second argument by arguing that he did not knowingly or recklessly misrepresent the financial condition of Reliance in the Offering Circulars, because the FHLBB and Peat Marwick did not determine that pushdown accounting could not be used until after the Offering Circulars were prepared and distributed and the s completed. This argument is unpersuasive. Felt, as a

fiduciary, is charged with knowledge of the laws that govern the transactions. *See Carey Lumber v. Bell*, 615 F.2d 370, 376 (5th Cir. 1980); *Anderson v. Currin (In re Currin)*, 55 B.R. 928, 934 (Bankr.D.Colo. 1985); *Antlers Roof-Truss & Builders Supply v. Storie (In re Storie)*, 216 B.R. 283, 287 (B.A.P. 10th Cir. 1997). Holding a fiduciary to such knowledge "prevents ignorance of the law from becoming a defense to nondischargeability and provides an incentive for individuals . . . who are engaged in occupations subject to special statutes to apprise themselves of their obligations under the law." *Carlisle Cashway, Inc. v. Johnson (In re Johnson)*, 691 F.2d 249, 257 (6th Cir. 1982), *quoted in In re Storie*, 216 B.R. at 287.

Felt testified in his deposition that he knew that under generally accepted accounting principles, the pushdown accounting method was only proper in offering in which approximately ninety percent of the transactions were at arm's length. Felt testified in his deposition that he had actual knowledge of the requirements for the use of pushdown accounting. Felt admitted that " . . . [investors] . . . purchased approximately 33% of defendant Felt's Reliance stock, paying no money down and using financing obtained from Specialty Finance Co., Felt's wholly-owned subsidiary." (Docket Entry No. 44, Tab 6, ¶ 31). Felt admitted that "[a]t all times material to this action, defendant Felt was solely responsible for the management and operation of Specialty Finance Co." (*Id.*, ¶ 33).

In his September 7, 1994 deposition, Felt testified as follows:

> Q: . . . [W]hen the preliminary offering circular was drafted, did you know that in order for purchase and push-down accounting to apply in connection with the sale of your Reliance stock, at least 90 percent of the stock had to be sold in arm's length transactions?
>
> A: I don't remember the percentage, whether it was actually 90 percent or not, but I think that that – I think I probably knew that. I don't remember the percentage.
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> . . . .
>
> Q: Are you clear that you knew at the time both the preliminary and final offering circulars were drafted that for purchase and push-down accounting to apply to the proposed sale of your Reliance stock, a high percentage of the stock had to be sold in arm's length transactions?
>
> A: Yes

(Docket Entry No. 44, Tab 5).

The undisputed evidence is that taking the evidence in the light most favorable to Felt, at a maximum, Felt knew that only sixty-seven percent of the Reliance stock could have been purchased in arm's length transactions,[6]

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[6] At a October 30, 1990 hearing before the Honorable Lynn N. Hughes, Beth Mizuno, a witness for the OTS, testified to the fact that in the transactions financed by Specialty Finance, " . . . there was really no transfer of ownership from Mr. Felt to those purchasers. So you couldn't get to that 90 percent threshold." When Ms. Mizuno was asked what percentage was reached if the Specialty Finance transaction was ignored, she answered, " . . . like 65 percent was actually transferred at arm's length. And you had to have at least 90 to utilize push-down." (Docket Entry No. 35, Tab A, p. 308).

far from the ninety percent required. The undisputed evidence is that when Felt issued the Preliminary and Final Offering Circulars, affirmatively stating that push-down accounting would apply and would result in a net worth for Reliance of $4.5 million, he knew the facts and circumstances that led the FHLBB and Peat Marwick to disallow pushdown accounting and require reissued financials showing the insolvent status of Reliance. The undisputed evidence does not support Felt's assertion that he had a good faith belief that pushdown accounting was appropriate for the transactions. At a minimum, Felt recklessly misrepresented the financial status of Reliance when he offered its stock to prospective purchasers. Felt willfully neglected his fiduciary duties under section 523(a)(4).

The undisputed evidence in the record shows that, as a matter of law, Felt willfully violated his fiduciary duties, rendering the judgment debt against him non-dischargeable under 11 U.S.C. § 523(a)(4), to the extent previously established in this court's orders.

IV. Order

This court GRANTS the OTS's motion for summary judgment. final judgment will be entered by separate order.

SIGNED on June 28, 2000, at Houston, Texas.

/s/ Lee H. Rosenthal
Lee H. Rosenthal
United States District Judge

APPENDIX G

IN THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF TEXAS HOUSTON DIVISION

OFFICE OF THRIFT SUPERVISION,	§	
	§	
Plaintiff,	§	CIVIL ACTION NO. H-94-3979
	§	Adversary No. 93-4416
VS.	§	
	§	
DAVID J. FELT,	§	
	§	
Defendant.	§	

FINAL JUDGMENT

(Filed Jun. 29, 2000)

The Office of Thrift Supervision seeks a declaratory judgment that its debt evidenced by the Final Judgment and Permanent Injunction of this court in *Federal Home Loan Bank Board v. David J. Felt*, Civil Action No. H-88-1204, is nondischargeable in bankruptcy.

Based upon this court's previous Memoranda and Orders, and the Memorandum and Opinion of June 28, 2000, this court now orders as follows:

1. That portion of the Final Judgment and Permanent Injunction of this court in *Federal Home Loan Bank Board v. David J. Felt*, Civil Action No. H-88-1204, which awards damages of $2,778,710 plus pre-judgment and post-judgment interest on said amount to the Office of Thrift Supervision, as trustee, in connection with the December 1986 sale and purchase of those shares of the common stock of Reliance Savings Association, Houston,

Texas to which the attached "Summary of Nonelecting Shareholders" makes reference, is determined to be DISCHARGEABLE in bankruptcy; and

2. The remainder of the Final Judgment and Permanent Injunction entered by the court in favor of the Office of Thrift Supervision, as trustee, in *Federal Home Loan Bank Board v. David J. Felt*, Civil Action No. H-88-1204, is determined to be NONDISCHARGEABLE in bankruptcy under 11 U.S.C. § 523(a)(4), based on the determination that the judgment debt arose from Felt's defalcation while acting in a fiduciary capacity and that Felt acted willfully in committing the defalcation.

This is a final judgment. Each party is to bear its own costs.

SIGNED on June 28, 2000, at Houston, Texas.

/s/ Lee H. Rosenthal
Lee H. Rosenthal
United States District Judge

SUMMARY OF
NONELECTING SHAREHOLDERS

SHAREHOLDER'S NAME	PAGE OF PX 9	SHARE CERT. NO.	NO. OF SHARES	NO. OF SHARES X 10,000
1. ALDRICH, DAVID C.	0000391	101	337	$ 3,370.
2. ALDRICH, LINDA S.	0000391	102	337	$ 3,370.
3. BAMBERG, GEORGE, et al.	0000391	104	1,159	$ 11,590.
4. BEDFORD, SEAN J.	0000391	109	382	$ 3,820.
5. BEIMGRABEN, OTTO	0000391	110	568	$ 5,680.
6. COLLIER, ROSE	0000392	120	144	$ 1,440.
7. DIEP, LOI	0000393	131	467	$ 4,670.
8. DORCEY, ALBERTA, et al.	0000393	132	212	$ 2,120.
9. EAGLE RIDGE ENTERPRISES	0000393	137	15,536	$155,380.
10. EARHART FRED	0000393	138	326	$ 3,260.
11. EMERSON, GARY	0000394	140, 141	6,889	$ 68,890.
12. EMERSON, PAULINE	0000394	142, 143	2,070	$ 20,700.
13. EVANS, BONNIE SUE	0000394	144	325	$ 3,250.
14. FIKE, RONALD E.	0000394	146	363	$ 3,630.
15. FRANCESCHI, MILICENT	0000394	148	269	$ 2,690.
16. FRANCESCHI, RENALDO	0000394	149	392	$ 3,920.
17. GORI, IMOGENE	0000395	162	203	$ 2,030.
18. GUZMAN, JOE, et al.	0000395	165	666	$ 6,660.
19. HAEDER, MARVIN	0000395	166	264	$ 2,640.
20. HALL & HALL	0000395	167	2,795	$ 27,950.
21. HAUSLER, JUDY ANN, et al.	0000396	172	893	$ 8,930.
22. HAUSLER, OSCAR, et al.	0000396	173	13,636	$136,360.
23. HAUSLER, OSCAR	0000396	174	4,349	$ 43,490.
24. HEAD, A.D. or HAUSLER, OSCAR	0000396	175	286	$ 2,860.
25. HOGAN, DEBBIE	0000396	180	2,287	$ 22,870.

26. IVES, J. HIETT, et al.	0000397	189	1,279	$ 12,790.
27. JOYCE, S. MARK	0000398	199	242	$ 2,420.
28. JOYCE, JANICE C.	0000398	200	194	$ 1,940.
29. KADLICK, DIANE P.	0000398	201	304	$ 3,040.
30. KADLICK, RICHARD J.	0000398	202, 203	529	$ 5,290.
31. LEWIS, LARRY, et al.	0000399	209	2,057	$ 20,590.
32. LORENZ, RUTH A.	0000399	213	475	$ 4,750.
33. LUNDE, HENRY J.	0000399	214	1,230	$ 12,300.
34. MAX, MAXINE, et al.	0000399	215	227	$ 2,270.
35. MATTLE, JR., EARL	0000399	220	285	$ 2,850.
36. MC LEOD, JANE K.	0000400	221	322	$ 3,220.
37. MEERS, STEVEN W.	0000400	222	3,784	$ 37,840.
38. MUKERJI, SANTOSH	0000400	230	330	$ 3,300.
39. MUTCHLER, ADELE C.	0000400	231	322	$ 3,220.
40. MUTCHLER, JOHN	0000400	232	322	$ 3,220.
41. MARTINEZ, OLYMPIO	0000401	238	384	$ 3,840.
42. O'DONNELL, J.M.	0000401	240	263	$ 2,630.
43. POPE, HAL	0000401	243	608	$ 6,080.
44. POPE, CHRISTINE	0000401	244	1,082	$ 10,820.
45. RAINBOLT, CAROL	0000401	243	739	$ 7,390.
46. RENFROE, HARRIS, et al	0000401	246	857	$ 8,570.
47. ROBBINS, FRANK	0000402	247	264	$ 2,640.
48. ROBBINS, JANET or FRANK	0000402	248, 249	773	$ 7,730.
49. ROSCA, MIRELLE	0000402	252	312	$ 3,120.
50. SALSER, ELDON or ANN MARIE	0000402	254	330	$ 3,300.
51. SIGMOND, DAVID	0000402	258	665	$ 6,650.
52. SPANGLER, MACON et al	0000403	260	1,723	$ 17,230.
53. STORMS, RANDOLF	0000403	262	648	$ 6,480.
54. THOMAS, EVELYN et al	0000403	265	1,948	$ 19,480.
55. TRGOVICH, M.A.	0000403	272	469	$ 4,690.

56. UDELL, ROBERT and LILLY	0000404	273	27,020	$270,200.
57. WARLICK, C.E. or SHIRLEY	0000404	274	3,761	$ 37,610.
58. WATSON, VELINDA	0000404	275	632	$ 6,320.
59. WERNER, ALICE	0000404	276	405	$ 4,050.
60. WERNER, JAMES	0000404	277	405	$ 4,050.
61. WIEDERHALL, A. or H.	0000404	281	1,054	$ 10,540.
62. WRIGHT, GAIL	0000404	283	250	$ 2,500.
63. ZISSA, ANGELINE or ANFONS	0000404 and 0000405	285, 286	6,915	$ 69,150.
64. ZUNIGA, JUAN or JOSEFINA	0000405	287	860	$ 8,600.
65. DRULEY, JOHN D.	0000405	288	14,800	$148,000.
66. MEEKS, RANDALL C.	0000405	289	14,500	$145,000.
67. GOLDMAN, ARTHUR	0000405	290	21,200	$212,000.
68. DAVIS, K.U.	0000405	292	19,726	$197,260.
69. LEWIS, JOHN R.	0000405	293	28,500	$285,000.
70. GUBITZ, STEPHEN P.	0000405	294	15,000	$150,000.
71. SPURLIN DEVELOP.	0000405	295	5,000	$ 50,000.
72. SILIVERMAN, STANLEY	0000405	296	14,500	$145,000.
73. BOYAR, J. WILLIAM	0000405	297	7,500	$ 75,000.
74. DANNATT, ALLAN	0000406	300	12,500	$125,000.
75. SHERBORNE, JANE	0000406	306	570	$ 5,700.
76. SHERBORNE, WILLIAM	0000406	307	570	$ 5,700.
77. THAKUR, SANESH	0000406	308	682	$ 6,820.
78. THAKUR, PUSHKA	0000406	309	87	$ 870.
79. SRJ TRUST	0000406	310	2,500	$ 25,000.
80. REINHART, H.J.	0000406	313 314	808	$ 8,080.
TOTAL				2,778,710

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APPENDIX H

IN THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF TEXAS HOUSTON DIVISION

IN RE: DAVID J. FELT, Debtor,	§	
OFFICE OF THRIFT SUPERVISION, Plaintiff,	§	Civil Action No. H-94-3979
	§	Bankruptcy No. 92-47538-H5-7
	§	Adversary No. 93-4416
v.	§	
DAVID J. FELT, Defendant.	§	

AMENDED FINAL JUDGMENT

(Filed Oct. 25, 2000)

In the final judgment entered on June 29, 2000 (Docket Entry No. 47), this court held dischargeable in bankruptcy $2,778,710 of the 1991 money judgment (the "judgment debt") that plaintiff Office of Thrift Supervision ("OTS") had secured against the debtor, defendant David J. Felt, in *Federal Home Loan Bank Board v. David J. Felt*, Civil Action No. H-88-1204 (S.D. Tex.) Now before the court is OTS's motion under Federal Rule of Civil Procedure 60(a) to correct clerical mistakes in the final judgment. OTS argues that a chart on which the court relied to determine the dischargeable portion of the judgment debt contains clerical errors that erroneously inflate the dischargeable amount of the judgment debt by

$367,740. The court attached the chart to the final judgment; the charge is titled, "Summary of Nonelecting Shareholders."

Felt filed a notice of appeal of the final judgment and the appeal is pending. The United States Court of Appeals for the Fifth Circuit has been informed of this court's inclination to grant OTS's Rule 60(a) motion, and, accordingly, has remanded the case for that purpose.

For the reasons explained in OTS's brief in support of its motion to correct clerical mistakes under Rule 60(a), this court hereby GRANTS OTS's motion and AMENDS the June 29, 2000, final judgment to reduce the dischargeable portion of the 1991 judgment debt by $367,740.

It is ORDERED:

1. that $2,410,970, plus pre-judgment and post-judgment interest of that amount, of the Final Judgment and Permanent Injunction of this court in *Federal Home Loan Bank Board v. David J. Felt*, Civil Action No. H-88-1204, in favor of the Office of Thrift Supervision, as trustee, is DISCHARGEABLE in bankruptcy; and

2. that the remainder of the Final Judgment and Permanent Injunction issued in *Federal Home Loan Bank Board v. David J. Felt*, Civil Action No. H-88-1204, is NONDISCHARGEABLE in bankruptcy under 11 U.S.C. § 523(a)(4), based on the determination that the judgment debt arose from Felt's defalcation while acting in a fiduciary capacity and that Felt acted willfully in committing the defalcation in connection with Felt's actions and

omissions concerning the December 1986 sale and purchase of the common stock of Reliance Savings Association, Houston, Texas.

Each party shall bear its own costs.

SIGNED on October 24, 2000, at Houston, Texas.

/s/ Lee H. Rosenthal
Lee H. Rosenthal
United States District Judge

APPENDIX I

11 USC § 101. Definitions

In this title –

* * *

(5) "claim" means –

(A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured;

* * *

(10) "creditor" means –

(A) entity that has a claim against the debtor that arose at the time of or before the order for relief concerning the debtor;

* * *

(12) "debt" means liability on a claim;

* * *

(15) "entity" includes person, estate, trust, governmental unit, and United States trustee;

* * *

APPENDIX J

11 USC § 523. Exceptions to discharge

(a) A discharge under . . . this title does not discharge an individual debtor from any debt –

* * *

(4) For fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny;

* * *

(11) provided in any final judgement, unreviewable order, or consent order or decree entered in any court of the United States or of any State, issued by a Federal depository institutions regulatory agency, or contained in any settlement agreement entered into by the debtor, arising from any act of fraud or defalcation while acting in a fiduciary capacity committed with respect to any depository institution or insured credit union;

* * *

(e) Any institution-affiliated party of a *insured depository institution* shall be considered to be acting in a fiduciary capacity with respect to the purposes of subsection (a) (4) or (11).

Supreme Court, U.S.
FILED
NOV 26 2001

No. 01-508

In the Supreme Court of the United States

DAVID J. FELT, PETITIONER

v.

OFFICE OF THRIFT SUPERVISION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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1408

QUESTIONS PRESENTED

1. Whether the Office of Thrift Supervision had standing to file and prosecute this adversary proceeding, which contests the dischargeability in bankruptcy of the monetary provisions of a judgment entered in OTS's favor as trustee for certain other injured persons.

2. Whether the terms of the district court's order granting judgment to OTS as trustee for certain other injured persons required OTS to assign its claims to those injured persons in 1991.

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In the Supreme Court of the United States

No. 01-508

DAVID J. FELT, PETITIONER

v.

OFFICE OF THRIFT SUPERVISION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals underlying the judgment appealed from (Pet. App. 1-16) is reported at 255 F.3d 220. The court of appeals' earlier opinion reversing the district court's grant of summary judgment on the issue of willfulness is unreported. The memoranda and orders that underlie the district court's amended final judgment (Pet. App. 20-35, 36-43, 49-72) are unreported.

JURISDICTION

The judgment of the court of appeals was entered on June 21, 2001. The petition for a writ of certiorari was

filed on September 19, 2001. This Court's jurisdiction is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. In December 1983, petitioner purchased all of the stock of Bowie County Savings and Loan Association in New Boston, Texas, a federally insured thrift institution. Petitioner borrowed nearly $1.5 million from American Guaranty, Inc. (AGI), a firm that he owned, to complete the purchase. Petitioner renamed the institution Reliance Savings Association. Petitioner harmed Reliance when he engaged in self-dealing by indirectly selling two AGI loans to a Reliance subsidiary. On August 29, 1986, after the Federal Home Loan Bank Board (FHLBB) instituted an enforcement action against him, petitioner agreed with the FHLBB that he would sell his interest in Reliance within six months, and Reliance consented to the entry of a cease and desist order based on various regulatory violations. By that time, both Reliance and AGI were either insolvent or on the brink of insolvency. Pet. App. 2-3.

In September 1986, petitioner sent a letter to AGI noteholders offering them the opportunity to exchange their AGI notes for Reliance stock. The material accompanying the letter—which included a "preliminary offering circular"—used unaudited financial statements and misrepresented the appropriate accounting treatment of the exchange of AGI notes for Reliance stock. As a result, the material falsely stated that stockholders' equity in Reliance would be $4.5 million after the transaction, a figure that far exceeded Reliance's actual net worth of approximately $96,000. The letter and accompanying material also did not disclose that Reliance was subject to a cease and desist order, that petitioner was required to dispose of his stock

under the agreement with the FHLBB, and that another entity petitioner owned would be financing one-third of the Reliance stock purchases on favorable terms. Pet. App. 4-5.

In September 1986, petitioner attempted to get FHLBB approval for the "preliminary offering circular," but approval was refused because the financial data included in it were unaudited. On December 22, 1986, petitioner sent the potential investors in Reliance a revised circular, in which he stated that the offering was "not required to be approved by the FHLBB." Pet. App. 6. The revised circular continued to state that Reliance would have a positive capital balance of $4.5 million after the sale. On December 31, 1986, petitioner completed the transaction. Approximately 150 AGI investors exchanged their notes for about 60% of the Reliance stock. A second group of five investors paid cash, and the remaining eight investors purchased approximately one-third of the Reliance stock, with the special financing provided by the entity owned by petitioner. *Ibid.*

After the transaction was completed, FHLBB determined that the sale had not been made at arm's length, because much of the Reliance stock had been financed on special terms by petitioner's entity, the AGI noteholders had been coerced into swapping AGI notes for Reliance stock, and AGI itself was an affiliate of the seller to begin with. As a result FHLBB declined to permit Reliance to count the stock purchases as new equity. Reliance therefore had a negative net worth of $5.6 million, rather than the positive equity of $4.5 million projected in the offering circulars. Because of its negative net worth, FHLBB placed the thrift into receivership in 1988. Pet. App. 7.

In April 1988, the FHLBB commenced an action against petitioner seeking rescission of the sale of Reliance stock, because the sale had been made without FHLBB approval and through the use of an offering circular that contained material misstatements and omissions. The district court found petitioner liable, ruling that petitioner knew that the stock would be worthless immediately after the sale. On January 9, 1991, the district court entered a judgment in favor of the Office of Thrift Supervision (OTS) (the successor to the FHLBB) and against petitioner (the "Reliance judgment") in the amount of $4.2 million "in trust for individuals * * * who purchased Reliance Savings Association stock from [petitioner] during December, 1986." The judgment was affirmed on appeal. Pet. App. 7-8.

2. Before OTS was able to collect on the Reliance judgment, petitioner filed for bankruptcy in a case that ultimately was administered under Chapter 7 of the Bankruptcy Code (11 U.S.C. 701 *et seq.*). OTS filed a claim for $6.4 million, which covered the Reliance judgment plus costs and interest. OTS also alleged that the debt was non-dischargeable, because, *inter alia*, it resulted from petitioner's "defalcation while acting in a fiduciary capacity." 11 U.S.C. 523(a)(4). On March 31, 1997, the district court *sua sponte* ruled that petitioner's actions were "willful" as a matter of law, and that petitioner's conduct therefore constituted "defalcation" under Section 523(a)(4). At the same time the court rejected petitioner's arguments that OTS lacked standing. Pet. App. 9, 36-48.

Petitioner appealed, arguing that OTS lacked standing to contest dischargeability on behalf of the individual investors and that there were material issues of fact on the questions of whether petitioner was a fiduciary

for purposes of Section 523 of the Bankruptcy Code, and if so, whether he breached his fiduciary duties. Petitioner also argued that the district court erred in granting summary judgment *sua sponte* on the issue of whether petitioner acted willfully in breaching his fiduciary duties. The court of appeals "reversed in part, vacated in part, and remanded in part" as to the district court's *sua sponte* grant of summary judgment on the issue of willfulness. *In re Felt*, 176 F.3d 478 (5th Cir. 1999) (unpublished). On remand, OTS moved for summary judgment on the question of willfulness, and after full briefing, the district court granted OTS's motion and entered final judgment for OTS on June 29, 2000. Pet. App. 9-10, 49-77.

3. The Fifth Circuit affirmed. The court determined that the issue of "willfulness" on the prior appeal would have been relevant only if the court had decided that petitioner had breached a fiduciary duty and that OTS had standing to pursue the action. Those issues had been fully briefed to the court on the prior appeal. Accordingly, the court determined that its prior decision had necessarily resolved those questions adversely to petitioner, and "the law of the case doctrine precludes reconsideration of [petitioner's] fiduciary status, his breach of his fiduciary duties, or OTS's standing to pursue this action." Pet. App. 12. The court also affirmed the district court's determination that, based on undisputed evidence viewed in the light most favorable to petitioner, petitioner's actions were willful violations of his fiduciary duties and therefore constituted "defalcation" for purposes of Section 523(a)(4). *Id.* at 13-16.

ARGUMENT

The court of appeals' decision was correct and does not conflict with any decision of this Court or any other court of appeals. Further review is therefore unwarranted.

1. The court of appeals correctly found that OTS had standing to contest the nondischargeability of petitioner's debt. Under 11 U.S.C. 523(c)(1), a debtor "shall be discharged * * * unless, on request of the creditor to whom such debt is owed, * * * the court determines such debt to be excepted from discharge." Accordingly, any "creditor to whom [the] debt is owed" may bring a claim of nondischargeability.

OTS has standing to contest the nondischargeability of the Reliance judgment because it is a "creditor to whom [the] debt is owed." A "creditor" is defined as an "entity that ha[d] a claim against the debtor that arose at the time of or before the order for relief concerning the debtor." 11 U.S.C. 101(10)(A).[1] A "claim" for purposes of the Bankruptcy Code is a "right to payment," which means "nothing more nor less than an enforceable obligation" 11 U.S.C. 101(5)(A); *Johnson* v. *Home State Bank*, 501 U.S. 78, 83 & n.4 (1991); *Pennsylvania Dep't of Pub. Welfare* v. *Davenport*, 495 U.S. 552, 559 (1990). The relevant portion of the January 9, 1991, Reliance judgment provided that "[t]he Office of Thrift Supervision, in trust for individuals * * * who purchased Reliance Savings Association stock from [petitioner] during December, 1986, shall recover from [petitioner]" the sum of $4,271,020, plus prejudgment interest, court costs, and postjudgment interest. Pet. App. 18. Thus, OTS has an enforceable right to receive

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[1] An "entity" is defined specifically to include a "governmental unit." 11 U.S.C. 101(15).

payment of that sum of money from petitioner, and OTS is therefore a "creditor to whom [the] debt is owed."[2]

2. Petitioner contends (Pet. 9-11) that the court of appeals' holding that OTS has standing to assert the nondischargeability of the Reliance judgment conflicts with the Eighth Circuit's decision in *Cannon* v. *Missouri*, 741 F.2d 1139 (1984). There is, however, no conflict. *Cannon* involved a suit by the State of Missouri to establish the nondischargeability of a restitution debt owing to eight individuals. The debt resulted from a successful civil suit brought by the Missouri Attorney General in state court against Cannon under the Missouri Merchandising Practices Act for alleged fraudulent misrepresentations as to the use of certain bond monies Cannon received. During the pendency of the civil action, Cannon commenced a Chapter 7 bankruptcy case. Thereafter, the state court entered an order holding that Cannon had violated the Act and enjoining any further violations. In addition, the state court ordered that Cannon make restitution to the eight individuals.

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[2] See also *Pennsylvania Dep't of Pub. Welfare*, 495 U.S. at 558-559 (Congress intended "debt" and "claim" to have coextensive meanings in Bankruptcy Code, connoting nothing more nor less than an enforceable obligation); *Fezler* v. *Davis (In re Davis)*, 194 F.3d 570, 573-577 (5th Cir. 1999); *FTC* v. *Austin (In re Austin)*, 138 B.R. 898 (Bankr. N.D. Ill. 1992) (FTC had standing to file claim and commence adversary proceeding to assert nondischargeability of debt arising from prior FTC order requiring debtor to set up consumer redress fund); *SEC* v. *Cross (In re Cross)*, 218 B.R. 76 (B.A.P. 9th Cir. 1998) (SEC had standing to prosecute nondischargeability action involving judgment requiring debtor to make restitution to investors); *SEC* v. *Hodge (In re Hodge)*, 216 B.R. 932 (Bankr. S.D. Ohio 1998); *SEC* v. *Kane (In re Kane)*, 212 B.R. 697, 700 (Bankr. D. Mass. 1997); *SEC* v. *Maio (In re Maio)*, 176 B.R. 170 (Bankr. S.D. Ind. 1994).

Unlike petitioner, Cannon owed no debt to the government that was seeking a declaration of nondischargeability. As the Eighth Circuit explained, the state court judgment "specifically ordered that restitution payments be made to eight enumerated individuals" and, as a matter of state law, "the Attorney General may not sue on behalf of private individuals in a private action." 741 F.2d at 1141 (citing *State ex rel. Barker* v. *Chicago & A.R.R.*, 178 S.W. 129 (Mo. 1915) (en banc)). For those reasons—which were all matters of Missouri law—the Eighth Circuit held that the State of Missouri could not pursue the claim of nondischargeability in *Cannon*. See 741 F.2d at 1142. By contrast, the Reliance judgment in this case specifically provided that OTS "shall recover" the funds at issue from petitioner, Pet. App. 18, and there is no statutory or other bar to the OTS's prosecution of an action of this sort. Accordingly, the decision of the Eighth Circuit in *Cannon* does not conflict with the Fifth Circuit's decision in this case.

3. Petitioner argues (Pet. 9-11) that the fact that OTS was not the only party authorized to enforce the Reliance judgment limits its ability to bring a nondischargeability claim. Petitioner relies on *Nathanson* v. *NLRB*, 344 U.S. 25, 27 (1952), in which this Court held that the NLRB is a creditor with respect to certain back pay awards under the National Labor Relations Act for purposes of bringing a nondischargeability claim under the Bankruptcy Act. In reaching that conclusion, the Court noted that "Congress has made the [NLRB] the only party entitled to enforce the [National Labor Relations Act]." *Ibid.* But that factor was not the basis of the Court's decision. The Court's decision in *Nathanson* instead turned on the definition of "creditor" under the Bankruptcy Act, see *id.* at 27 n.1

(citing definition), and the fact that, as the Court explained, "[a] back pay order is a command to pay an amount owed the Board as agent for the injured employees." *Id.* at 27. As the Fifth Circuit explained in *Fezler* v. *Davis (In re Davis)*, 194 F.3d 570, 576-577 (1999), numerous courts have agreed since *Nathanson* that "an entity with statutory authority to prosecute and collect a claim against the debtor, even if other persons are entitled to ultimate payment on the claim, is a creditor in its own right, absent a statutory provision to the contrary." See *ibid.* (citing cases). That principle governs this case as well.

4. Petitioner also contends (Pet. 7) that further review is warranted to address the question "whether a federal regulatory agency has standing to collect a debt owed to third parties where the judgment states the regulatory agency shall assign their interest to the third parties." As explained above, the debt in this case was owed to OTS, albeit as a trustee for third parties. Petitioner cites no other case addressing the situation in which a federal agency seeking to obtain a declaration of nondischargeability has been ordered by a court to assign its debt to third parties for whom it is acting as trustee. Further review of any fact-bound questions presented by that situation is accordingly unwarranted.

In any event, petitioner rests his argument on the contention that OTS was required to assign its interests to third parties by September 1, 1991, and that OTS's failure to do so by that date should preclude it from pursuing its nondischargeability claim in this case. The district court did not, however, require that OTS assign its claims by any particular date. The Reliance judgment provided that OTS was to send a copy of the judgment "to each person who purchased Reliance Savings Association stock" from petitioner, that "[e]ach

stockholder has until September 1, 1991, to file a claim" with OTS for its share of the damages, and that OTS "shall make a pro rata assignment of its interest in the judgment to all the stockholders who file a claim by September 1, 1991." Pet. App. 18-19. Thus, although the district court required the stockholders to file their claims with OTS prior to September 1, 1991, the court did not set any deadline for OTS to assign its interests to the stockholders. Petitioner offers no reason why the district court's decision should be construed to have set such a deadline for OTS. Moreover, if there were a valid claim that OTS had violated an obligation under the terms of the judgment, this bankruptcy action would not have been the appropriate forum to litigate that claim.

CONCLUSION

The petition for writ of certiorari should be denied.

Respectfully submitted.

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